

JAN 22 2002 IF

**Michael N. Milby, Clerk**

**DECLARATION OF JAMES I. JACONETTE IN FURTHER  
SUPPORT OF THE LEAD PLAINTIFF MOTION OF  
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA  
AND IN OPPOSITION TO THE COMPETING LEAD  
PLAINTIFF MOTIONS**

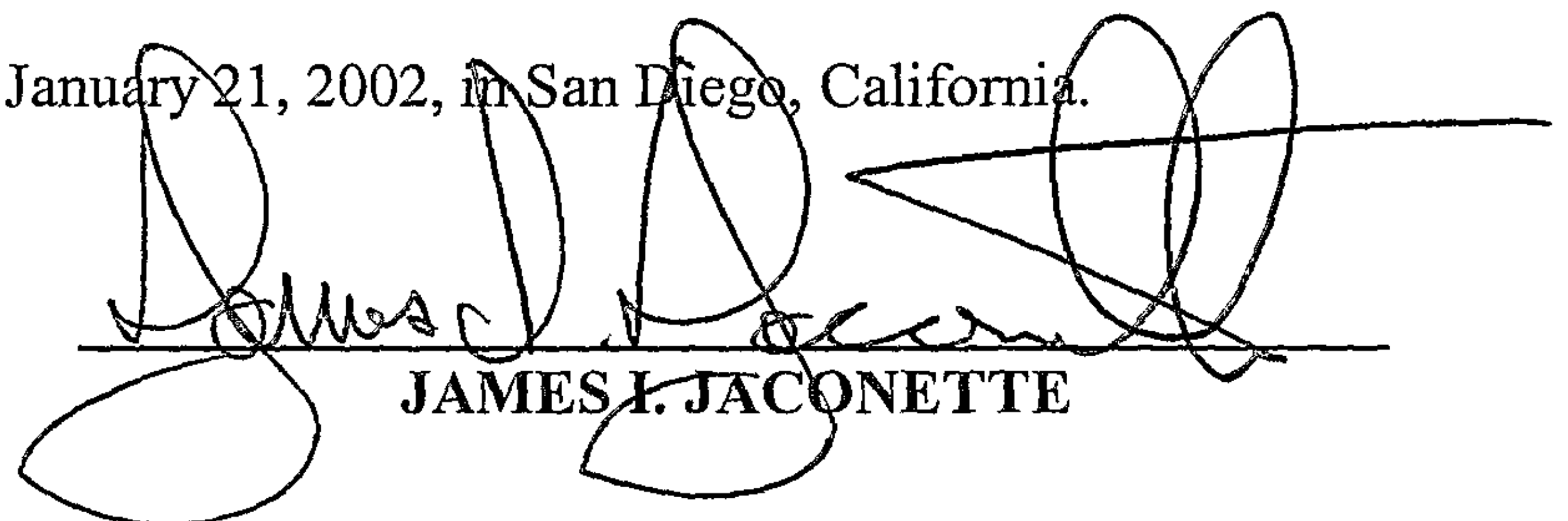
I, JAMES I JACONETTE, DECLARE:

1. I am an attorney duly licensed to practice before all of the courts of the State of California. I am an associate with the law firm of Milberg Weiss Bershad Hynes & Lerach LLP, one of the counsel of record for the Regents of the University of California, and proposed lead counsel. I have personal knowledge of the matters stated herein and, if called upon, I could and would competently testify thereto.

2. Attached are true and correct copies of the following exhibits:

Exhibit 1	<i>Miami Daily Business Review</i> article dated January 2, 2002;
Exhibit 2	Enron Corp. Form 8-K filed with the SEC on November 8, 2001;
Exhibit 3	Jonathon Weil, "Basic Principle of Accounting Tripped Enron," <i>The Wall Street Journal</i> , November 12, 2001;
Exhibit 4	John Dorschner, "Florida Last-Minute Enron Stock Buys Probed," <i>The Miami Herald</i> , January 17, 2002;
Exhibit 5	<i>Myers v. Schering-Plough Corp.</i> , No. 01-CV-829 (KSH/RJH), Order (D.N.J. July 3, 2001);
Exhibit 6	<i>In re NCI Building Sys., Inc. Sec. Litig.</i> , No. H-01-1280, Order (S.D. Tex. Dec. 28, 2001);
Exhibit 7	Complaint filed in <i>Benak v. Alliance Capital Management L.P.</i> , No. 01-CV-5734 (D.N.J. Dec. 7, 2001); and
Exhibit 8	Complaint filed in <i>Roy v. Alliance Capital Management L.P.</i> , No. 01-CV-2449-T-24MS (M.D. Fla. Dec. 20, 2001).

I declare under the penalty of perjury under the laws of the United States of America that the foregoing is true and correct, executed on January 21, 2002, in San Diego, California.

  
JAMES I. JACONETTE



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**Miami Daily Business Review**

January 2, 2002

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**Florida's public employee pension system**, overseen by pro-tort reform Republicans, has become the most litigious institutional investor in the country.

The Florida State Board of Administration (FSBA), which manages \$96 billion in retirement funds, is currently involved in nearly 300 securities fraud lawsuits against companies whose stock it has owned. Typically, the agency claims that management deception or other misbehavior drove down the price of the pension fund's shares and lowered the value of its investments.

But the agency also offers a moral rationale for its aggressive legal approach. "We have all seen an increasing number of corporate actions that border on criminal - and sometimes are criminal," says FSBA executive director John T. "Tom" Herndon, the architect of the legal strategy. "Someone has to question the ethics of these business practices."

While there are no statistics ranking the most active plaintiffs in the shareholder fraud arena, experts say FSBA, a 217-employee agency that manages retirement funds for 750,000 state and county workers and retirees, leads the pack.

FSBA currently serves as lead plaintiff or co-lead plaintiff in eight different actions, and has filed its own private lawsuits against 14 other companies. Just in the last two months, FSBA has won lead status in securities fraud class actions against Dollar General Corp. in U.S. District Court in Nashville, and against Critical Path, Inc., in federal district court in San Francisco.

By comparison, CalPERS, the giant California public employees pension fund frequently cited as a model in the corporate governance monitoring arena, has acted as lead plaintiff in only one case and petitioned to lead one other.

FSBA's legal approach has begun to draw criticism from judges, securities attorneys, and even insiders in the institutional investor community. Some question whether the time and effort involved in prosecuting all these cases has yielded a worthwhile return to beneficiaries.

"I am concerned with any frivolous litigation that in effect replaces productive employment and company profits with legal defense costs," says Russell Bjorkman, a member of the FSBA's six-member Investment Advisory Council and a former trustee and chairman of the Miami-Dade County police and firefighters' pension fund. He plans to call for a review of the agency's litigation policy.

**Exhibit 1**



Several federal judges also have taken disapproving notice of FSBA's activism. At least three times in the past two years, judges have turned down the agency's request to lead a suit on grounds that the FSBA already had exceeded the limits set by the 1995 Private Securities Litigation Reform Act.

In November 1999, Judge Donald Whyte of the U.S. District Court in San Francisco rejected the FSBA's petition to serve as lead plaintiff in a securities fraud lawsuit against McKesson HBOC Inc. Whyte dubbed the FSBA a "professional plaintiff."

The FSBA's litigation spree is more than a bit ironic. Its governing board is made up of three elected Republican officials - Gov. Jeb Bush, state Treasurer Tom Gallagher and state Comptroller Bob Milligan. One of their party's most cherished goals has been to reduce the amount of securities fraud litigation and other suits directed at businesses. Early in his term, Gov. Bush pushed through strong tort reform legislation.

Asked to comment, Bush issued a statement that it's "the fiduciary responsibility of the state to protect participants of the Florida retirement system."

Milligan admitted that he was not aware of how many legal actions FSBA had launched or participated in. But if such aggressive litigation "is a necessary part of our whole fiduciary effort," he said, "I have to support it."

Gallagher said that "when corporate governance doesn't do the right thing" and stock prices fall as a result, FSBA has the right to take legal action. As a trustee, he said, he "will follow the recommendations of the executive director."

#### Man with a mission

Herndon, 55, has had a long career as a Florida public official under Democratic elected leaders. He previously served as chief of staff to Govs. Lawton Chiles and Bob Graham and as executive director of the state Department of Revenue. Prior to his appointment by Chiles to run the FSBA in November 1996, he headed his own governmental consulting firm.

Herndon seems surprised that anyone would even ask questions about his agency's activist legal stance. While "fiduciary responsibility" is FSBA's main rationale for its aggressive litigation, Herndon takes a more expansive view of its duty. "We have to act in the best financial interest of our members," he says.

"But we have other obligations that go beyond that. ... Is it OK to spend a million dollars to buy back the house of some CEO who leaves after a year? Who is going to ask these questions? Who stands in the place of the shareholders who don't have the power to do it?"

This moralistic approach was in evidence in 1998, when FSBA took the lead in suing UCAR International, based in Nashville, for securities fraud - even though FSBA's losses were only \$200,000 and the pension fund already had sold all its stock in the company.

In its Annual Report on Corporate Governance for last year, the FSBA board of trustees declared that it had acted as a "private attorney general" in that case. UCAR, the report said, had conspired with its main competitor to fix the world price of carbon, and had made false statements in its annual report about how its business was highly price-competitive "when the opposite was true."

In its suit, FSBA charged that UCAR officers committed securities fraud when they lowered their previous earnings reports because of the government fines the company had to pay for price-fixing. But Herndon says that it was the officers' federal criminal antitrust conviction - more than the financial losses to FSBA beneficiaries - that prompted his agency to sue UCAR.

#### Pushing other plaintiffs aside

A more typical FSBA fraud case is the one against Dollar General, in which FSBA is co-lead plaintiff.

Dollar General operates 4,500 retail stores which sell very low-priced merchandise. Despite its less than glamorous business line, the company attracted a great deal of investor attention from May 1998 until last April by releasing a series of highly positive news announcements that claimed record sales and earnings. Dollar General CEO Cal Turner also boasted of his company's success in interviews on CNBC.

The result of this media blitz, according to the lawsuit, was to drive up the price of Dollar General shares. That enabled the company to sell \$200 million of notes at favorable interest rates, and allowed the Turner family to unload a substantial share of its controlling interest at highly favorable prices.

But on April 30 of this year, Dollar General issued a press release that was not so glowing. It admitted that profits for 1998 and 1999 were lower than previously reported. That news sent the stock into a nose dive, plummeting 37 percent from its peak to \$16.50 a share.

That same day, the Pirelli Armstrong Tire retirees medical fund filed a suit accusing Dollar General executives of fraud for deliberately misleading shareholders about the firm's financial condition. FSBA didn't enter the case until June 29 - the filing deadline - when it moved to displace the original plaintiffs on grounds that its financial losses of \$10.4 million were larger than those of the Pirelli Armstrong fund.

That sort of last-minute takeover by larger investors and law firms is a common practice in securities fraud cases, says James Newman, executive director of the Securities Class Actions Services, a New York City research group that tracks lawsuits for pension funds and other institutions.

Not surprisingly, attorneys who are shoved aside don't like it. One who faces that prospect is Jeffrey R. Krinsk, a partner at Finkelstein & Krinsk in San Diego. He alleges that the FSBA makes a habit of showing up at the last minute and demanding lead plaintiff status in cases that have already been developed by other plaintiffs.

Krinsk filed a securities fraud complaint in May against Applied Micro Circuits Corp. of San Diego on behalf of two private investors. Since then, FSBA has filed a petition to act as lead plaintiff. But Krinsk says Barrack Rodos & Bacine of Philadelphia, which represents the FSBA, never even filed its own complaint on behalf of the pension agency.

Krinsk calls the repeated use of such piggybacking tactics "an abuse of [the FSBA's] institutional status." Steven Basser, a partner in Barrack Rodos' San Diego office, declined to comment.

Nevertheless, Herndon downplays his agency's legal activism. For a fund that owns shares of nearly 2,000 companies, he says, 300 lawsuits is a relatively modest number. In 90 percent of those cases, he notes, the FSBA takes only a passive role. Besides, he adds, suing companies is not a new policy for his agency.

"The board was active in corporate governance long before I became director - voting proxies, proposing guidelines, even filing lawsuits," Herndon says. But, he concedes, "Maybe there has been an increase in the degree of intensity since I came in."

#### Reform failure

Curbing securities fraud suits was a key part of the GOP's "Contract with America" in the mid-90s. Overriding President Clinton's veto, Congress passed the Private Securities Litigation Reform Act in 1995 to rein in what many lawmakers described as a glut of frivolous suits brought by opportunistic plaintiff lawyers who claimed fraud every time the stock market took a tumble.

Among its key provisions, the law compels plaintiffs to make a stronger showing of insider profiteering in order to initiate discovery proceedings, and it stays discovery until a judge rules on motions to dismiss the suit. As a result, the number of cases that are summarily dismissed before discovery has risen from 13 percent to 30 percent since the law was passed.



But, to the surprise of the law's sponsors, the number of securities fraud suits filed has gone up since it was passed. According to the Stanford Law School Securities Class Action Clearinghouse, there were 188 such suits filed in all of 1995. In the first six months of 2001, however, there already have been 261.

One reason for the increase in suits, of course, is the sluggish performance of the stock market in recent months, which has prompted some investors to search for villains. But another is the generally increased litigiousness of institutional investors.

Ironically, Congress encouraged big institutions like pension funds to take the lead in class actions, on the theory that they would be more restrained and responsible in securities litigation. But critics contend that some institutional investors, notably the FSBA, have taken the congressional encouragement too much to heart.

The trend is beginning to create controversy. "Corporate litigation is becoming a bigger topic across the country, especially as stock market losses have grown," Newman says. On the other hand, Newman's group reported last month that many public and corporate pension plans are losing out on hundreds of millions of dollars in class-action settlements by failing simply to file claims.

Unlike CalPERS, the FSBA has no official policy on when to undertake litigation. "We don't have any hard and fast rules on selecting suits to file," Herndon says. "Our own staff suggests some cases. Others are brought to us by outside law firms, other institutions, corporate governance groups and by outside investment advisers."

In contrast, CalPERS has a written policy, with specific criteria for choosing when to participate in securities fraud litigation. For example, the potential damages must be more than \$2 million, large enough to warrant the staff time devoted to the case. The written guidelines also pose the following question to guide decisions: "Would CalPERS' involvement add value to the settlement?"

Still, the Florida pension agency is hardly alone in its legal assaults on public companies. Other activist institutional litigants include the State of Wisconsin Investment Board and the Louisiana School Employees Retirement System - although neither is nearly as aggressive as FSBA.

The public pension fund lawsuits, scattered around the country, have taken place below the radar screen of all but the most attentive observers. One reason is that the lead plaintiff often doesn't emerge until long after the suit is filed. As a result, even political leaders with oversight responsibility often are unaware that public pension funds are involved.

FSBA's attorneys repeatedly have argued that the 1995 reform law's limitation on "professional plaintiffs" does not apply to institutional investors. That claim is based on a statement in the House of Representatives' conference report: "Institutional investors seeking to serve as lead plaintiff may need to exceed this limitation and do not represent the type of professional plaintiff this legislation seeks to restrict. As a result, the Conference Committee grants courts discretion to avoid the unintended consequences of disqualifying institutional investors from serving [as lead plaintiff] more than five times in three years."

Robert J. Giuffra, a partner at Sullivan & Cromwell in New York City, who was the Senate Banking Committee's chief counsel when the law was passed, says FSBA's position on limitations is correct. "Congress wanted to put these cases in the hands of the adults," he says, "and institutional investors are the adults." The judges who have ruled against FSBA on the issue, he adds, "are just wrong."

But this arguable exemption for institutional investors is something which plaintiff law firms can use to sidestep the reform law's intended restrictions on assembling groups of small shareholders. Newman says some firms take cases initiated by an individual plaintiff to a big institutional investor like FSBA, and push the institutional client to seek lead plaintiff status, which means bigger legal fees for the law firms.

Herndon, though, argues that it's good public policy for institutional investors like the FSBA to take the lead. He says FSBA's size and bargaining clout "could lead to a decrease in attorneys' fees and thus a higher return to beneficiaries."



For all of the talk about protecting the retirees' money, however, the returns from most securities fraud lawsuits are not that large. Across the country and for all cases, settlements average about \$12 million, with legal fees and expenses eating up about a third of the total and the remainder of the spoils divided among thousands of shareholders, according to National Economic Research Associates, a consulting and analysis firm based in New York.

The FSBA's recoveries haven't been huge so far this year. From Jan. 1 through Aug. 15, the FSBA reports that it recovered about \$3.6 million in settlements from participating in various class-action shareholder suits - a tiny fraction of the value of its \$96 billion investment portfolio.

Some observers inside the institutional investor community question the value of all this litigation. One veteran pension fund official, who didn't want to be named, says his colleagues are increasingly critical of "investors who seem to be so eager to go into court. A lot of us think it makes more sense to do what CalPERS does and identify the companies that need to shape up before they become a problem, instead of spending so much time and energy suing the people who screw up."

But FSBA's legal approach draws surprising praise from one of Florida's leading critics of plaintiff lawyers and anti-business litigation. Jon Shebel, president of Associated Industries of Florida, a powerful business lobbying group in Tallahassee, stoutly defends the FSBA, which is overseen by his strong tort reform ally, Jeb Bush.

For the FSBA to behave in any other way, Shebel insists, "would be an absolute dereliction of their duty."

#### Mixed rulings by judges

Nevertheless, the FSBA's frequent requests to act as lead plaintiff have drawn mixed reviews from federal judges around the country.

In ruling on the FSBA's petition to serve as lead plaintiff in the McKesson HBOC Inc. case, Judge Whyte noted that, by the agency's own admission, it already was lead or co-lead plaintiff in six other shareholder fraud class-action lawsuits. He rejected the argument that the public pension fund was exempt from the statutory limit on the number of times parties can serve as lead plaintiff.

"The text of the statute," he wrote, "contains no flat exemption for institutional investors." Moreover, he added, "Congress also desired to increase client control over plaintiff's counsel, and allowing simultaneous prosecution of six securities actions is inconsistent with that goal."

Three months earlier, a federal district judge in Cleveland also rejected FSBA's petition to serve as lead plaintiff, in a class-action shareholder fraud suit against Telxon Corp. He also said the FSBA had exceeded the statutory limitations. The reform law, wrote the judge, "places the burden on the FSBA to demonstrate why the bar should not be applied in this case."

And last March, a federal district judge in Erie, Pa., turned down FSBA's bid to become lead plaintiff in a suit against Rent-Way Inc. Although the judge ruled that another plaintiff had a larger stake in the case, he also noted FSBA's heavy workload in shareholder fraud cases. "It appears that, in addition to serving as lead plaintiff in a number of cases, FSBA is also a frequent nonlead plaintiff in securities actions," he added.

But these rebuffs hardly discouraged Tom Herndon. "I make it a practice never to disagree in public with a federal judge," Herndon says, noting that other judges have set aside the statutory limits under the reform law and supported FSBA's petitions to serve as lead plaintiff.

Indeed, on June 28, U.S. District Judge William H. Orrick in San Francisco selected FSBA as lead plaintiff in a suit against Critical Path Inc., a California Internet messaging company. He said judges have the discretion to override the statute's limits.

Three weeks later, U.S. Magistrate Judge Joe D. Brown in Nashville approved FSBA's petition to serve as co-lead plaintiff in the securities fraud suit against Dollar General. Judge Brown made his decision even though the FSBA's attorney acknowledged that during the previous three years, the agency had served as lead plaintiff in securities fraud



lawsuits against DaimlerChrysler, Vesta Insurance Group, Northrop Grumman, Sykes Enterprises Inc., Pediatrix Medical Group, Parametric Technology Corp., UCAR International and Samsonite Securities.

Legally overstretched?

Now FSBA faces bitter opposition to its request to act as lead plaintiff in a securities fraud suit against Applied Micro Circuits. In papers filed with the U.S. District Court in San Diego, Jeffrey Krinsk wrote, "FSBA is the embodiment of the professional plaintiff which the [1995 reform law] sought to eliminate."

Krinsk also asked whether FSBA has the resources and ability to handle so many class-action cases simultaneously and fully protect other shareholders' interests. "Can the FSBA possibly lend the oversight and involvement necessary to direct this [Applied Micro Circuits] action given its responsibility for directing dozens of other actions?"

That seems a fair question. In addition to its other duties, FSBA's seven-lawyer general counsel's office currently is overseeing seven large law firms handling about two dozen shareholder fraud cases which the agency is actively litigating. But Herndon does not see this as a problem. "We have to keep in mind the best use of our resources and the time of our staff," he says, "but we have tried to do that in a conscientious way."

Up to now, Herndon says, he's received no criticism from his political bosses of the FSBA's litigiousness. In response to Russell Bjorkman's statement that he would seek a review of the FSBA's litigation policies, Herndon says, "If they want to discuss litigation, we'll be glad to do it."

But he expresses confidence that his legal approach would be upheld. "The trustees expect us to exercise good judgment, and apparently so far they believe we have," he says. "We've had no indication that they think we're too aggressive or not aggressive enough."

'The board

was active

in corporate

governance long before

I became

director,' says Tom Herdon. 'Maybe there has been an

increase in

the degree of intensity since I came in.'

LOAD-DATE: January 03, 2002







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## ENRON CORP OR

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### Exhibit 2

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UNITED STATES SECURITIES AND EXCHANGE  
COMMISSION  
WASHINGTON, D.C. 20549

**FORM 8-K**

CURRENT REPORT

Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

Date of Report: **November 8, 2001**

Commission File Number 1-13159

**ENRON CORP.**

(Exact name of registrant as specified in its charter)

Oregon

47-0255140

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer Identification  
Number)

Enron Building  
1400 Smith Street  
Houston, Texas

77002

-----  
(Address of principal executive  
Offices)

-----  
(Zip Code)

(713) 853-6161

-----  
(Registrant's telephone number, including area code)

## ENRON CORP.

**Item 5. Other Events.**

Enron Corp. (NYSE: ENE) is providing information to investors concerning several important matters:

- o A required restatement of prior period financial statements to reflect: (1) recording the previously announced \$1.2 billion reduction to shareholders' equity reported by Enron in the third quarter of 2001; and (2) various income statement and balance sheet adjustments required as the result of a determination by Enron and its auditors (which resulted from information made available from further review of certain related-party transactions) that three unconsolidated entities should have been consolidated in the financial statements pursuant to generally accepted accounting principles. The restatement is outlined in TABLE 1;
- o Enron intends to restate its financial statements for the years ended December 31, 1997 through 2000 and the quarters ended March 31 and June 30, 2001. As a result, the previously-issued financial statements for these periods and the audit reports covering the year-end financial statements for 1997 to 2000 should not be relied upon;
- o The accounting basis for the \$1.2 billion reduction to shareholders' equity mentioned above;
- o The Special Committee appointed by Enron's Board of Directors to review transactions between Enron and related parties;

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- o Information regarding the LJM1 and LJM2 limited partnerships formed by Enron's then Chief Financial Officer, the former CFO's role in the partnerships, the business relationships and transactions between Enron and the partnerships, and the economic results of those transactions as known thus far to Enron, which are outlined in TABLE 2; and
- o Transactions between Enron and other Enron employees.

The restatements discussed below affect prior periods. After taking into account Enron's previously disclosed \$1.2 billion adjustment to shareholders' equity in the third quarter of 2001, these restatements have no effect on Enron's current financial position.

As used herein, "Enron" means Enron Corp. or one or more of its subsidiaries or affiliates. The dollar amounts and percentages set forth herein are rounded amounts and percentages.

.....

1. Background on Special Purpose Entities and Related-Party Transactions



Enron, like many other companies, utilizes a variety of structured financings in the ordinary course of its business to access capital or hedge risk. Many of these transactions involve "special purpose entities," or "SPEs." Accounting guidelines allow for the non-consolidation of SPEs from the sponsoring company's financial statements in certain circumstances. Accordingly, certain transactions

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between the sponsoring company and the SPE may result in gain or loss and/or cash flow being recognized by the sponsor, commonly referred to by financial institutions as "monetizations."

LJM Cayman, L.P. ("LJM1") and LJM2 Co-Investment, L.P. ("LJM2") (collectively "LJM") are private investment limited partnerships that were formed in 1999. Andrew S. Fastow, then Executive Vice President and Chief Financial Officer of Enron, was (from inception through July 2001) the managing member of the general partners of LJM1 and LJM2. Enron believes that the LJM partnerships have as limited partners a significant number of institutions and other investors that are not related parties to Enron. These partnerships are a subject of the Special Committee's investigation and it is possible that the Committee's review will identify additional or different information concerning matters described herein.

## 2. Restatement of Prior Period Financial Statements

Enron will restate its financial statements from 1997 to 2000 and the first and second quarters of 2001 to: (1) reflect its conclusion that three entities did not meet certain accounting requirements and should have been consolidated, (2) reflect the adjustment to shareholders' equity described below, and (3) include prior-year proposed audit adjustments and reclassifications (which were previously determined to be immaterial in the year originally proposed). Specifically, Enron has concluded that based on current information:

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- o The financial activities of Chewco Investments, L.P. ("Chewco"), a related party which was an investor in Joint Energy Development Investments Limited Partnership ("JEDI"), should have been consolidated beginning in November 1997;
- o The financial activities of JEDI, in which Enron was an investor and which was consolidated into Enron's financial statements during the first quarter of 2001, should have been consolidated beginning in November 1997; and
- o The financial activities of a wholly-owned subsidiary of LJM1, which engaged in derivative transactions with Enron to permit Enron to hedge market risks of an equity investment in Rhythms NetConnections, Inc., should have been consolidated into Enron's financial statements beginning in 1999.

The effects of the restatements are outlined in Table 1. A description of the

restatements follows the table.

TABLE 1

ENRON CORP.  
RESTATEMENTS  
DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS  
UNAUDITED

	1997	1998	1999	2000	1ST QTR 2001	2ND QTR 2001	3RD QTR 2001
Net income as reported	\$ 105 (a)	\$ 703	\$ 893	\$ 979	\$ 425	\$ 404	\$ (618)
Restatements:							
Consolidation of JEDI and Chewco	(45)	(107)	(153)	(91)	--	--	--
Consolidation of LJM1 subsidiary	--	--	(95)	(8)	--	--	--
Raptor equity adjustment	--	--	--	--	--	--	--
Prior year proposed audit adjustments and reclassifications	(51)	(6)	(2)	(33)	17	5	(17)
NET INCOME RESTATED	9	590	643	847	442	409	(635)
Diluted EPS as reported	0.16	1.01	1.10	1.12	0.49	0.45	(0.84)
DILUTED EPS RESTATED	(0.01)	0.86	0.79	0.97	0.51	0.46	(0.86)
Recurring net income as reported	515	698	957	1,266	406	404	393
Restatements:							
Consolidation of JEDI and Chewco	(45)	(107)	(153)	(91)	--	--	--
Consolidation of LJM1 subsidiary	--	--	(95)	(8)	--	--	--
Raptor equity adjustment	--	--	--	--	--	--	--
Prior year proposed audit adjustments and reclassifications	(51)	(6)	(2)	(33)	17	5	(17)
RECURRING NET INCOME RESTATED	419	585	707	1,134	423	409	376
Diluted recurring EPS as reported	0.87	1.00	1.18	1.47	0.47	0.45	0.43
DILUTED RECURRING EPS RESTATED	0.71	0.85	0.87	1.33	0.49	0.46	0.41
Total assets as reported	22,552	29,350	33,381	65,503	67,260	63,392	
Restatements:							
Consolidation of JEDI and Chewco	447	160	187	(192)	--	--	
Consolidation of LJM1 subsidiary	--	--	(222)	--	--	--	
Raptor equity adjustment	--	--	--	(172)	(1,000)	(1,000)	
Prior year proposed audit adjustments and reclassifications	(79)	(87)	(147)	(364)	(1,249)	247	
TOTAL ASSETS RESTATED	22,920	29,423	33,199	64,775	65,011	62,639	61,177 (b)
Debt as reported	6,254	7,357	8,152	10,229	11,922	12,812	
Restatements:							
Consolidation of JEDI and Chewco	711	561	685	628	--	--	
Consolidation of LJM1 Subsidiary	--	--	--	--	--	--	
Raptor equity adjustment	--	--	--	--	--	--	
Prior year proposed audit adjustments and reclassifications	--	--	--	--	--	--	
DEBT RESTATED	6,965	7,918	8,837	10,857	11,922	12,812	12,978 (b)
Equity as reported	5,618	7,048	9,570	11,470	11,727	11,740	
Restatements:							
Consolidation of JEDI and Chewco	(262)	(391)	(540)	(810)	--	--	
Consolidation of LJM1 subsidiary	--	--	(166)	60	60	60	
Raptor equity adjustment	--	--	--	(172)	(1,000)	(1,000)	
Prior year proposed audit adjustments and reclassifications	(51)	(57)	(128)	(242)	(286)	11	
EQUITY RESTATED	5,305	6,600	8,736	10,306	10,501	10,811	9,491 (b)



- 
- (a) After effect of significant contract restructuring charge totaling \$463 million (after tax)
  - (b) Represents estimated balances pending completion of September 30, 2001 financial statements

A. Restatement Number 1

Enron's decision that Chewco should be consolidated beginning in November 1997 is based on current information that Chewco did not meet the accounting criteria to qualify as an unconsolidated SPE. As a result of Chewco's failure to meet the criteria, JEDI, in which Chewco was a limited partner, also did not qualify for nonconsolidation treatment. Because of

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those consolidations, Enron's prior-year reported debt amounts will be increased by both JEDI's and Chewco's borrowings. The net effect will reduce Enron's prior-years' reported net income and shareholders' equity amounts. In addition, Enron's net income is reduced for specific JEDI revenues previously allocated to Chewco, relating to the appreciation in value of Enron stock, which eliminate upon consolidation. This, in effect, reduces Enron's share of JEDI's earnings.

B. Restatement Number 2

Enron's decision that the LJMI subsidiary should be consolidated in 1999 and 2000 is based on Enron's current assessment that the subsidiary did not qualify for nonconsolidation treatment because of inadequate capitalization. Accordingly, Enron now believes that the hedging transactions in which Enron engaged with the LJMI subsidiary (related to Enron's investment in the stock of Rhythms NetConnections, Inc.) should have been consolidated into Enron's financial statements for 1999 and 2000. This consolidation has the effect of reducing Enron's net income in 1999 and 2000 and shareholders' equity in 1999 and increasing shareholders' equity in 2000, thus eliminating the income recognized by Enron on these derivative transactions.

C. Restatement Number 3

As discussed in Section 3 below, concerning Enron's recent disclosure of a \$1.2 billion reduction to shareholders' equity in the third quarter of 2001, shareholders' equity will be reduced by \$172 million beginning as of June 30, 2000, and by an additional \$828 million beginning as of March 31, 2001, to properly record notes receivable (described in Section 3 below) as a reduction to equity.

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D. Restatement Number 4

The restatements will also include prior-year proposed audit adjustments and reclassifications which were determined to be immaterial in the year originally proposed.

### 3. Accounting Basis for \$1.2 Billion Reduction in Shareholders' Equity

Enron's previously-announced \$1.2 billion reduction of shareholders' equity primarily involves the correction of the effect of an accounting error made in the second quarter of 2000 and in the first quarter of 2001. As described in more detail below, four SPEs known as Raptor I-IV (collectively, "Raptor") were created in 2000, permitting Enron to hedge market risk in certain of its investments. (LJM2 invested in these entities, but the related-party nature of the transaction is not relevant to the accounting correction). As part of the capitalization of these entities, Enron issued common stock in exchange for a note receivable. Enron increased notes receivable and shareholders' equity to reflect this transaction. Enron now believes that, under generally accepted accounting principles, the note receivable should have been presented as a reduction to shareholders' equity (similar to a shareholder loan). This treatment would have resulted in no net change to shareholders' equity. The net effect of this initial accounting entry was to overstate both notes receivable and shareholders' equity by approximately \$172 million (which represented less than 2% of shareholders' equity at the time) in each of the second quarter, third quarter, and year-end financial statements of Enron for the year 2000.

In the first quarter of 2001, Enron entered into contracts with Raptor that could have obligated Enron to issue Enron common stock in the future in exchange for notes receivable. Enron

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accounted for these transactions using the accounting treatment described in the preceding paragraph. This resulted in an additional overstatement of both notes receivable and shareholders' equity by \$828 million. As a result of these errors, shareholders' equity and notes receivable were overstated by a total of \$1 billion in the unaudited financial statements of Enron at March 31 and June 30, 2001.

In the third quarter of 2001, Enron purchased LJM2's equity interests in Raptor for \$35 million. As previously discussed, Enron accounted for this transaction as a reduction to Enron shareholders' equity and notes receivable by \$1.2 billion. Enron recorded a \$200 million equity reduction (which was part of the \$1.2 billion reduction) related to the excess of the fair value of contracts deliverable by Enron over the notes receivable recorded in shareholders' equity, as adjusted.

Prior period financials will be restated to adjust shareholders' equity for all periods affected as shown in Section 2.

### 4. The Special Committee

Based on various reports and information concerning Enron's transactions with certain related parties, on October 31, 2001, the Board of Directors elected William Powers, Dean of the University of Texas School of Law, to the Board, and appointed Dean Powers as Chairman of a newly formed Special Committee of the Board to conduct an independent investigation and review of transactions between Enron and certain related parties. The Special Committee also was charged with taking any disciplinary action that it deems appropriate, communicating with

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the Securities and Exchange Commission (which has commenced a formal investigation of these matters), and recommending to the Board any other appropriate actions. The other members of the Special Committee are independent directors Frank Savage, CEO of Savage Holdings LLC, Paulo Ferraz Pereira, Executive Vice President of investment bank Group Bozano, and Herbert S. Winokur, Jr., Chairman and CEO of Capricorn Holdings, Inc.

The Special Committee has retained the law firm of Wilmer, Cutler & Pickering as its counsel. The firm's representation is led by William R. McLucas, former head of the Division of Enforcement of the SEC. Wilmer, Cutler has retained Deloitte & Touche to provide related accounting advice to the law firm. The Special Committee's review is in its early stages. It will include an analysis of both the underlying substance and business purposes of the transactions, as well as an analysis of their financial impact on Enron and, to the extent information is available, on the related parties. The duration of the Special Committee's review, and the ultimate results of that review, have not yet been determined. While the information provided herein reflects Enron's current understanding of the relevant facts, it is possible that the Special Committee's review will identify additional or different information concerning these matters.

#### 5. The LJM Limited Partnerships and Transactions with Enron

##### A. The LJM Partnerships.

As discussed above, LJM1 and LJM2 are private investment limited partnerships. Enron believes that, under the LJM1 and LJM2 limited partnership agreements (as with many similar agreements in private equity investing), the general partners are entitled to receive a percentage of the profits in excess of their portions of total capital contributed to the partnerships depending

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upon the performance of the partnerships' investments. Enron also believes that the general partners are entitled to receive annual management fees based in part on formulas that take into account the total amount of capital committed and/or invested by the limited partners. Enron now believes that Mr. Fastow received in excess of \$30 million relating to his LJM management and investment activities. Enron believes that the initial capital commitments to LJM1 were \$16 million, and the aggregate capital commitments to LJM2 were \$394 million.

LJM1 and LJM2 were described to the Enron Board of Directors as potential sources of capital to buy assets from Enron, potential equity partners for Enron investments, and counterparties to help mitigate risks associated with Enron investments. The Board also was informed that LJM1 and LJM2 intended to transact business with third parties. Prior to approving Mr. Fastow's affiliation with LJM1 and LJM2, the Board determined that Mr. Fastow's participation in the partnerships would not adversely affect the interests of Enron. The Board approved the initial transaction with LJM1 and recognized that Enron may (but was not required to) engage in additional transactions with LJM1.

The Board directed that certain controls be put into place relating to Mr. Fastow's involvement with the partnerships and transactions between Enron and the partnerships. The Board required review and approval of each transaction by the Office of the Chairman, the Chief Accounting Officer and the Chief Risk Officer. The Board also recognized the ability of the Chairman of the Board to require Mr. Fastow to resign from the partnerships at any time, and directed that the Audit and Compliance Committee conduct annual reviews of transactions between Enron and



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LJM1 and LJM2 completed during the prior year. Whether these controls and procedures were properly implemented is a subject of the Special Committee's investigation.

Enron believes that, as of July 31, 2001, Mr. Fastow sold his interests in LJM1 and LJM2 to Michael J. Kopper, and that Mr. Fastow ceased to be the managing member of their general partners. Prior to that time, Mr. Kopper reported to Mr. Fastow as a non-executive officer of an Enron division. Enron believes Mr. Kopper resigned from Enron immediately before purchasing Mr. Fastow's interests in LJM2. Mr. Fastow is no longer working for Enron.

#### B. General Summary of LJM Transactions.

From June 1999 through September 2001, Enron and Enron-related entities entered into 24 business relationships in which LJM1 or LJM2 participated. These relationships were of several general types, including: (1) sales of assets by Enron to LJM2 and by LJM2 to Enron; (2) purchases of debt or equity interests by LJM1 or LJM2 in Enron-sponsored SPEs; (3) purchases of debt or equity interests by LJM1 or LJM2 in Enron affiliates or other entities in which Enron was an investor; (4) purchases of equity investments by LJM1 or LJM2 in SPEs designed to mitigate market risk in Enron's investments; (5) the sale of a call option and a put option by LJM2 on physical assets; and (6) a subordinated loan to LJM2 from an Enron affiliate. The financial results of these transactions are summarized in Table 2 below.

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TABLE 2

#### UNAUDITED SUMMARY OF LJM TRANSACTIONS (IN MILLIONS)

<Table>  
<Caption>

	LJM INVESTMENT	CASH AND OTHER VALUE RECEIVED BY LJM	LJM NET CASH FLOW	IMPACT OF LJM TRANSACTIONS ON ENRON'S PRE-TAX EARNINGS
2001:				
Sale of Assets	\$ --	\$ --	\$ --	\$ 0.7
Purchases of Equity/Debt in Enron-Sponsored Special Purpose Entities	--	52.5	52.5	--
Investments in Enron Affiliates	3.4	49.7	46.3	--
Portfolio Special Purpose Entities	--	75.5	75.5	(166.2) (a)
Call Option	--	--	--	--
Transactions with LJM and Other Entities	--	--	--	--
Transaction with LJM and Whitewing	--	--	--	--
Total	\$ 3.4	\$ 177.7	\$ 174.3	\$ (165.5)

2000:

Sale of Assets	\$ 30.0(b)	\$ 32.4	\$ 2.4	\$ 86.6
Purchases of Equity/Debt in Enron-Sponsored Special Purpose Entities	100.7	64.4	(36.3)	--
Investments in Enron Affiliates	66.5	19.3	(47.2)	--
Portfolio Special Purpose Entities	127.1	148.5	21.4	517.9(a,c)
Call Option	11.3	12.5	1.2	--
Transactions with LJM and Other Entities	7.5	11.7	4.2	--
Transaction with LJM and Whitewing	40.3	--	(40.3)	--
Total	\$ 383.4	\$ 288.8	\$ (94.6)	\$ 604.5

1999:

Sale of Assets	\$ --	\$ --	\$ --	\$ --
Purchases of Equity/Debt in Enron-Sponsored Special Purpose Entities	73.8	15.4	(58.4)	2.4
Investments in Enron Affiliates	44.5	1.0	(43.5)	16.9
Portfolio Special Purpose Entities	64.0	95.2(d)	31.2	119.5(c)
Call Option	--	--	--	--
Transactions with LJM and Other Entities	--	--	--	--
Transaction with LJM and Whitewing	--	38.5	38.5	--
Total	\$ 182.3	\$ 150.1	\$ (32.2)	\$ 138.8

Summary Totals:

Sale of Assets	\$ 30.0	\$ 32.4	\$ 2.4	\$ 87.3
Purchases of Equity/Debt in Enron-Sponsored Special Purpose Entities	174.5	132.3	(42.2)	2.4
Investments in Enron Affiliates	114.4	70.0	(44.4)	16.9
Portfolio Special Purpose Entities	191.1	319.2	128.1	471.2
Call Option	11.3	12.5	1.2	--
Transactions with LJM and Other Entities	7.5	11.7	4.2	--
Transaction with LJM and Whitewing	40.3	38.5	(1.8)	--
Total	\$ 569.1	\$ 616.6	\$ 47.5	\$ 577.8

Estimated Fair Value of Existing  
LJM Investments

\$ 43.6(e)

&lt;/Table&gt;

- (a) The pre-tax earnings impact of transactions with LJM2 through the Raptor SPEs was approximately \$532 million in 2000 and \$545 million for the nine months ended September 30, 2001. During 2000 and the nine months ended September 30, 2001, the Raptor SPEs hedged losses related to Enron investments of \$501 million and \$453 million respectively. The 2001 pre-tax earnings amount includes a \$711 million pre-tax charge in the quarter ended September 30, 2001 related to the termination of the Raptor SPEs.
- (b) This amount excludes a seller financed note from Enron to LJM of approximately \$70 million.
- (c) These pre-tax earnings resulted from a transaction with an LJM1 affiliate related to Enron's equity investment in Rhythms Netconnections, Inc. As previously stated, Enron now believes, based on current information, that the financial activities of the LJM1 affiliate should have been consolidated into its financial statements in 1999 and 2000 and will be restating prior years' financial statements to reflect this change. The pre-tax earnings / (loss) impact of this transaction was approximately \$119.5 million and (\$14.1) million in 1999 and 2000 respectively.
- (d) This amount represents Enron's estimate of the value received in Enron common stock, a portion of which was restricted. The estimate was based on a 36% discount off of the screen price on the date of issuance for shares that were restricted and estimated proceeds received by LJM from the sale of the unrestricted shares.
- (e) This amount represents Enron's estimated fair value of the six investments made by LJM that remain outstanding.

#### C. Sale of Assets.

In June 2000, LJM2 purchased dark fiber optic cable from Enron for a purchase price of \$100 million. LJM2 paid Enron \$30 million in cash and the balance in an interest-bearing note for \$70 million. Enron recognized \$67 million in pre-tax earnings in 2000 related to the asset sale. Pursuant to a marketing agreement with LJM2, Enron was compensated for marketing the fiber to others and providing operation and maintenance services to LJM2 with respect to the fiber. LJM2 sold a portion of the fiber to industry participants for \$40 million, which resulted in Enron recognizing agency fee revenue of \$20.3 million. LJM2 sold the remaining dark fiber for \$113 million in December 2000 to an SPE that was formed to acquire the fiber. In December 2000, LJM2 used a portion of the proceeds to pay in full the note and accrued interest owed to Enron. At the time of LJM2's sale of the fiber to the SPE, Enron entered into a derivative contract which served as credit support for the benefit of some of the debt holders of a third-party investor in the SPE. This credit support provided the lender with a specified rate of return. As a result, Enron's credit exposure under the \$70 million note was replaced with \$61 million in remaining exposure under the derivative contract. LJM2 earned \$2.4 million on its resale of the fiber.

#### D. Purchases of Equity/Debt in Enron-Sponsored SPEs.

Between September 1999 and December 2000, LJM1 or LJM2 purchased equity or debt interests in nine Enron-sponsored SPEs. LJM1 and LJM2 invested \$175 million in the nine SPEs. These transactions enabled Enron to monetize assets and generated pre-tax earnings to Enron of \$2 million in 1999.

Enron believes that LJM received cash of \$15 million, \$64 million and \$53



million in 1999, 2000 and 2001, respectively, relating to its investments in these entities. In three instances, third-party financial institutions also invested in the entities. LJM invested on the same terms as the third-party investors. In one of these nine transactions, Enron entered into a marketing agreement with LJM2 that provided Enron with the right to market the underlying equity. This arrangement gave Enron profit potential in proceeds received after LJM2 achieved a specified return level. In six of these nine transactions, Enron repurchased all or a portion of the equity and debt initially purchased by LJM.

The SPEs owned, directly or indirectly, a variety of operating and financial assets. For example, Yosemite Securities Trust was a finance entity which facilitated Enron's ability to raise funds in the capital markets through the use of credit-linked notes, a standard financing arrangement offered by investment banks. Osprey Trust is beneficially-owned by a number of financial institutions and is a limited partner in Whitewing Associates, L.P., an Enron unconsolidated affiliate ("Whitewing"). Enron is the other partner. Whitewing purchased certain Enron investments for future sale.

In addition, as a result of these transactions, Enron was able to monetize equity interests with investment banks. These monetizations resulted in Enron's recognizing \$146 million and \$5 million in pre-tax earnings in 2000 and 2001, respectively, and \$252 million in cash inflows, all in 2000.

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#### E. Investment in Enron Affiliates.

In two transactions, LJM2 made direct and indirect investments in stock (and warrants convertible into stock) of New Power Holdings, Inc. ("NPW"). NPW initially was a wholly-owned subsidiary of Enron, subsequently included other strategic and financial investors, and in October 2000 became a public company. NPW is engaged in the retail marketing and retail sale of natural gas, electricity and other commodities, products and services to residential and small commercial customers in the United States. In January 2000, LJM2 invested \$673,000 in Cortez Energy Services LLC ("Cortez"), a limited liability company formed by Enron and LJM2, and Enron contributed five million shares of NPW stock to Cortez. In July 2000, in a private placement, LJM2 purchased warrants exercisable for NPW stock for \$50 million on the same terms as third-party investors. Enron believes that LJM2 still owns these investments.

In September 1999, LJM1 acquired from Enron a 13% equity interest in a company owning a power project in Brazil for \$10.8 million, and acquired redeemable preference shares in a related company for \$500,000. Enron recognized a \$1.7 million loss on the sale of these interests to LJM1. Enron recognized revenues of \$65 million, \$14 million and \$5 million from a commodity contract with the company owning the power project in 1999, 2000 and 2001, respectively. As part of an exclusive marketing arrangement to sell LJM1's equity in the project to third-parties and to limit LJM1's return, Enron paid LJM1 a \$240,000 fee in May 2000. In 2001, Enron repurchased LJM1's 13% equity interest and the redeemable preference shares for \$14.4 million. Enron currently owns this equity interest.

In December 1999, LJM2 paid Enron \$30 million for a 75% equity interest in a power project in Poland. Enron recognized a \$16 million gain in 1999 on the sale. Enron paid \$750,000 to LJM2

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as an equity placement fee. In March 2000, Enron repurchased 25% of the equity in the Polish power project from LJM2 for \$10.6 million, and Whitewing acquired the remaining 50% from LJM2 for \$21.3 million. Enron and Whitewing still own their respective equity interests.

In December 1999, LJM2 acquired a 90% equity interest in an Enron entity with ownership rights to certain natural gas reserves for \$3 million. As a result, Enron recognized \$3 million in revenue from an existing commodity contract. Subsequently, LJM2 assigned a portion of its ownership interest in the entity to Enron and Whitewing at no cost (to achieve certain after-tax benefits). Enron believes LJM2 continues to own its remaining interest.

#### F. Portfolio SPEs.

Enron and LJM established a series of SPEs in order to mitigate market exposures on Enron investments, including investments in NPW, Rhythms NetConnections, Inc., and other technology, energy, and energy-related companies. LJM made \$191 million in equity investments in five separate SPEs, three of which (Raptor I, II and IV) were also capitalized with Enron stock and derivatives which could have required the future delivery of Enron stock. Raptor III was capitalized with an economic interest in warrants convertible into stock of NPW. The fifth SPE is discussed in Section 2B above. Enron subsequently engaged in hedging transactions with these SPEs, which included price swap derivatives, call options and put options. The derivatives and options generally were intended to hedge Enron's risk in certain investments having an aggregate notional amount of approximately \$1.9 billion.

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With respect to the four Raptor SPEs, Enron acquired LJM2's equity in the SPEs during the third quarter of 2001 for \$35 million. Enron recognized pre-tax earnings (losses) relating to risk management activities of \$119 million, \$518 million and (\$166) million in 1999, 2000 and 2001, respectively, including the effect of a \$711 million pre-tax charge recognized in 2001, related to the termination of the Raptor SPEs. During 2000 and the nine months ended September 30, 2001, the Raptor SPEs hedged losses of \$501 million and \$453 million, respectively. The fifth SPE was used to hedge Enron's exposure arising from an investment in the stock of Rhythms NetConnections, Inc. However, it was subsequently determined that it did not meet the criteria to qualify for unconsolidated treatment. (See Section 2B for a discussion of the restatement related to the fifth SPE.)

In total, LJM1 and LJM2 invested \$191 million and received \$319 million (an estimated \$95 million of which is non-cash value from the receipt of 3.6 million shares of Enron restricted stock) related to their investments in these five SPEs.

#### G. Call Option.

In May 2000, Enron purchased a call option from LJM2 on two gas turbines, at the same time that LJM2 contracted to purchase the gas turbines from the manufacturer. Enron paid LJM2 \$1.2 million for this right during a seven-month period in 2000. The call option gave Enron the right to acquire these turbines from LJM2 at LJM2's cost, which was \$11.3 million. The call option was subsequently assigned from Enron to an Enron-sponsored SPE capitalized by a third-party financial institution. In December 2000, the call option was exercised by the SPE and it acquired the turbines from LJM2 at cost.



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#### H. Transactions with LJM and Other Entities.

Enron sold its contractual right to acquire a gas turbine to a utility for \$15.8 million in July 2000. Enron recognized a pre-tax gain of \$3.5 million on the transaction. At the same time, the utility entered into a put option agreement with LJM2 relating to the turbine under which the utility paid LJM2 \$3.5 million. Subsequently, upon the execution of an engineering, procurement and construction contract with a wholly-owned subsidiary of Enron, the utility assigned the contractual right to acquire the gas turbine to that subsidiary.

In December 1999, Enron sold an equity investment in Enron Nigeria Barge Ltd. to an investment bank and provided seller financing. In June of 2000, LJM2 purchased this equity investment directly from the investment bank for \$7.5 million and the assumption of the seller-financed note from Enron. In September 2000, LJM2 sold the equity investment to an industry participant for \$31.2 million. The proceeds from LJM2's sale were used by LJM2 to repay the principal and interest on the note from Enron in the amount of \$23.0 million. The remaining \$8.2 million repaid LJM2's \$7.5 million purchase price and provided a profit of \$700,000 to LJM2.

#### I. Transaction between LJM and Whitewing.

In December 1999, a wholly-owned subsidiary of Whitewing entered into a \$38.5 million credit agreement with LJM2, the borrower. The loan had a term of one year and carried an interest rate of LIBOR+2.5%. The loan amount (including interest) of \$40.3 million was repaid by LJM2 in 2000.

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#### J. Currently Outstanding LJM2 Transactions.

Enron believes that LJM2 currently has interests in six of the investments described above in which LJM2 originally invested \$124 million, and that LJM2 has received cash inflows of \$27 million from these investments. These investments include \$23 million in equity in two Enron-sponsored SPEs, \$32.5 million in equity in Osprey Trust \$3 million in equity in an Enron affiliate, and \$50.7 million in direct equity investments in NPW (representing two transactions).

Enron and LJM2 also entered into various agreements relating to cash management services, employee services, and office space provided by Enron to LJM2. In addition, Enron paid LJM2 a management fee for certain transactions, and other transaction fees described above. Enron also reimbursed LJM2 for transaction-related expenses (such as legal and tax fees and other costs) associated with some of the transactions described above.

#### 6. Other Transactions

Like many other companies involved in trade and finance, Enron (through affiliates, subsidiaries, and SPEs) routinely engages in financing arrangements with third-party financial institutions, including commercial banks, investment banks and institutional investors, to fund acquisitions of assets or businesses, project development activities, and similar business arrangements. These activities are transacted with third parties using structures similar in some respects to the arrangements entered into with LJM. Enron provides credit support to the creditors of SPEs through the use of financial guarantees and hedging contracts. The payment of fees to third-party



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financial institutions and institutional investors, such as debt and equity placement fees and structuring fees, is common in debt and equity syndications.

#### 7. Other Employee Transactions

From June 1993 through November 1997, an Enron subsidiary was the general partner of JEDI and a third-party, the California Public Employees' Retirement System ("CalPERS"), was the limited partner. In November 1997, JEDI made a liquidating distribution to CalPERS of \$383 million. Concurrently, Chewco purchased a limited partnership interest in JEDI for \$383 million, \$132 million of which was financed by an interest-bearing loan from JEDI to Chewco, and \$240 million of which was borrowed from a third-party financial institution (supported by a guarantee from Enron). The restatement resulting from the Chewco transaction is discussed in 2A. Based on current information, Enron believes that a non-executive officer of an Enron division, Michael J. Kopper, was an investor in the general partner of Chewco and, at the time of the purchase, also was the manager of the Chewco general partner.

From December 1997 to December 2000, Chewco received distributions of \$433 million from JEDI. Among other things, Chewco used a portion of these distributions to make repayments on its JEDI loan and to repay an additional borrowing from the third-party financial institution.

In December 1999, Chewco purchased a \$15 million equity interest in Osprey Trust, an Enron-sponsored SPE, from LJMI.

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In March 2001, Enron purchased Chewco's limited partnership interest in JEDI for \$35 million. In September 2001, Enron paid an additional \$2.6 million to Chewco in connection with a tax indemnification agreement between JEDI, Chewco and Enron. Of the total purchase consideration, \$26 million was used by Chewco to make a payment on the JEDI loan. Chewco currently has an outstanding balance due on the JEDI loan of \$15 million. JEDI is currently a wholly-owned subsidiary of Enron.

Enron now believes that Mr. Kopper also was the controlling partner of a limited partnership that (through another limited partnership) in March 2000 purchased interests in affiliated subsidiaries of LJMI. Enron also now believes that four of the six limited partners of the purchaser were, at the time of the investment, non-executive officers or employees of Enron, and a fifth limited partner was an entity associated with Mr. Fastow. These officers and employees, and their most recent job titles with Enron, were Ben Glisan, Managing Director and Treasurer of Enron Corp.; Kristina Mordaunt, Managing Director and General Counsel of an Enron division; Kathy Lynn, Vice President of an Enron division; and Anne Yaeger, a non-officer employee. Enron is terminating the employment of Mr. Glisan and Ms. Mordaunt. Ms. Lynn and Ms. Yaeger are no longer associated with Enron and Enron believes they are now associated with LJM2. At the time these individuals invested in the limited partnership, LJMI had ceased entering into new transactions with Enron. However, some pre-existing investments involving LJMI and Enron were still in effect, and Enron believes that these investments resulted in distributions or payments to LJMI and to the limited partnership in which these individuals invested.

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Pursuant to a services agreement among Enron, LJM1, and LJM2, Enron made available to LJM1 and LJM2 a portion of the time of certain of its employees to provide administrative assistance to the general partners of LJM1 and LJM2. Mr. Kopper, Ms. Lynn and Ms. Yaeger, among other Enron employees, were made available to LJM1 or LJM2 from time to time during their employment by Enron.

This statement includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by Enron or on its behalf. These forward-looking statements are not historical facts, but reflect Enron's current expectations, estimates and projections. All statements contained herein which address future operating performance, events or developments that are expected to occur in the future (including statements relating to earnings expectations) are forward-looking statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements herein include results of the Special Committee's review and results of the SEC investigation.

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# Item 7. Exhibits.

## (c) Exhibits.

Exhibit 99.1 - Enron Corp. press release dated November 8, 2001 regarding related party and off-balance sheet transactions and restatement of earnings

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

ENRON CORP.

Date: November 8, 2001

By: /s/ RICHARD A. CAUSEY

-----  
Richard A. Causey  
Executive Vice President and Chief  
Accounting Officer  
(Principal Accounting Officer)

## INDEX TO EXHIBITS

NO. -----	DESCRIPTION -----
Exhibit 99.1	- Enron Corp. press release dated November 8, 2001 regarding related party and off-balance sheet transactions and restatement of

## earnings

{ENRON LOGO}

Enron  
P.O.Box 1188  
Houston, TX 77251-1188

Mark Palmer  
(713) 853-4738

-----  
ENRON PROVIDES ADDITIONAL INFORMATION ABOUT RELATED PARTY AND OFF-BALANCE SHEET  
TRANSACTIONS; COMPANY TO RESTATE EARNINGS FOR 1997-2001  
-----

FOR IMMEDIATE RELEASE: Thursday, Nov. 8, 2001

HOUSTON - Enron Corp. (NYSE: ENE) today provided additional information about various related party and off-balance sheet transactions in which the company was involved. The information was posted today on the company's website at [www.enron.com/corp/sec](http://www.enron.com/corp/sec) and also made available in a Form 8-K Report filed today with the Securities and Exchange Commission (SEC).

Specifically, Enron's filing provides information about:

- o a required restatement of prior period financial statements to reflect the previously disclosed \$1.2 billion reduction to shareholders' equity, as well as various income statement and balance sheet adjustments required as the result of a determination by Enron and its auditors, based on current information, that certain off-balance sheet entities should have been included in Enron's consolidated financial statements pursuant to generally accepted accounting principles;
- o the restatement of its financial statements for 1997 through 2000 and the first two quarters of 2001. As a result, financial statements for these periods and the audit reports relating to the year-end financial statements for 1997 through 2000 should not be relied upon;
- o the accounting basis for the above-mentioned reduction to shareholders' equity;
- o the special committee appointed by the Enron Board of Directors to review transactions between Enron and related parties;
- o information regarding the two LJM limited partnerships formed by Enron's then Chief Financial Officer, his role in the partnerships, the business relationships and transactions between Enron and the partnerships, and the economic results of those transactions as known thus far; and



- o transactions between Enron and certain other Enron employees.

"We believe that the information we have made available addresses a number of the concerns that have been raised by our shareholders and the SEC about these matters," said Ken Lay, Enron Chairman and CEO. "We will continue our efforts to respond to investor requests for information about our operational and financial condition so they can evaluate, appreciate and appropriately value the strength of our core businesses."

#### Restatement of Earnings

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As further described on Enron's website, and its Form 8-K Report, Enron will restate prior years' financial statements to reflect its review of current information concerning the transactions discussed below. After taking into account Enron's previously disclosed adjustment to shareholders' equity in the third quarter of 2001, these restatements have no effect on Enron's current financial position.

Based on this review, Enron has determined that:

- o the financial activities of Chewco Investments, L.P. (Chewco), a related party which was an investor in Joint Energy Development Investments Limited Partnership (JEDI), should have been consolidated beginning in November 1997;
- o the financial activities of JEDI in which Enron was an investor and which was consolidated into Enron's financial statements during the first quarter of 2001, should have been consolidated beginning in 1997; and
- o the financial activities of a wholly-owned subsidiary of LJMI, which engaged in structured transactions with Enron that were designed to permit Enron to mitigate market risks of an equity investment in Rhythms NetConnections, Inc., should have been consolidated into Enron's financial statements beginning in 1999.

Enron's current assessment indicates that the restatement will include a reduction to reported net income of approximately \$96 million in 1997, \$113 million in 1998, \$250 million in 1999 and \$132 million in 2000, increases of \$17 million for the first quarter of 2001 and \$5 million for the second quarter and a reduction of \$17 million for the third quarter of 2001. These changes to net income are the result of the retroactive consolidation of JEDI and Chewco beginning in November 1997, the consolidation of the LJMI subsidiary for 1999 and 2000 and prior year proposed audit adjustments. The consolidation of JEDI and Chewco also will increase Enron's debt by approximately \$711 million in 1997, \$561 million in 1998, \$685 million in 1999 and \$628 million in 2000. The restatement will have no negative impact on Enron's reported earnings for the nine month period ending Sept. 2001.

Enron is one of the world's leading energy, commodities and services companies. The company markets electricity and natural gas, delivers energy and other physical commodities, and provides financial and risk management services to customers around the world. Enron's Internet address is [www.enron.com](http://www.enron.com). The stock is traded under the ticker symbol "ENE."

This press release includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by Enron or on its behalf. These forward-looking statements are not historical facts, but reflect Enron's current expectations, estimates and projections. All statements contained in this press release which address future operating performance, events or developments that are expected to occur in the future (including

statements relating to earnings expectations) are forward-looking statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements herein include results of the Special Committee's review and results of the S.E.C. investigation.

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## Heard on the Street Basic Principle Of Accounting Tripped Enron

By Jonathan Weil  
Staff Reporter of The Wall Street Journal

11/12/2001

The Wall Street Journal

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What could Arthur Andersen have done to protect the investing public from Enron? Brushing up on a basic accounting textbook might have helped, some critics say.

Confirming investors' fears, the Houston energy trader Thursday filed a lengthy disclosure document with the Securities and Exchange Commission declaring that its financial statements going back to 1997 "should not be relied upon" and will have to be restated. Among other problems, Enron acknowledged overstating its net income by a total of \$586 million, or 20%. Enron's financial statements long have been widely assailed as indecipherable. Now, it turns out, they were just plain wrong.

But what is most striking about the latest disclosures is that they show Enron's misstatements weren't limited merely to judgment calls and gray areas for the green-eyeshade crowd to debate. Portions of Enron's accounting practices amounted to violations of elementary accounting principles, some accounting specialists say.

Citing client-confidentiality rules, an Andersen spokesman, David Tabolt, declines to comment on his firm's work for Enron, which on Friday agreed to be bought by crosstown rival Dynegy. He calls Enron's disavowal of its previous financial statements an "unfortunate situation" and says Andersen is cooperating with the SEC's Enron investigation and the special committee formed by Enron to investigate the company's accounting and disclosure practices.

Consider the primary reason for the \$1.2 billion reduction in shareholder equity that Enron revealed in mid-October, sparking much of the downdraft in the company's shares. At the time, Enron said the reduction came about because it had decided to unwind certain transactions with some limited partnerships with which it had done business. On Thursday, however, Enron acknowledged that the original accounting for the transactions violated generally accepted accounting principles.

Starting in early 2000, the company said last week, Enron issued shares of its own common stock to four "special-purpose entities," in exchange for which it received a note receivable. Enron said it had increased both its note-receivable assets and shareholder equity, a move the company called "an accounting error" that it is correcting. Under GAAP, the payment a company receives when issuing stock only counts as equity if it is cash. As a result, Enron's 2000 audited financial statements overstated the company's notes-receivable assets and shareholder equity by \$172 million. And Enron's 2001 unaudited statements overstated them by \$828 million. The \$1 billion overstatement represents 8.5% of Enron's previously reported shareholder equity as of June 30.

"It is basic accounting that you don't record equity until you get cash, and a note doesn't count as cash," says Lynn Turner, a former chief accountant for the SEC. "The question that raises is: How did both partners and the manager on this audit miss this simple Accounting 101 rule?" Adds Douglas Carmichael, an accounting professor at Baruch College in New York: "Anyone that's an accountant looking at the entry should have known" it violated GAAP.

An Enron spokesman, Vance Meyer, says, "The accounting error was just that -- an error," explaining that, "We believed it was not material. However, it was, of course, corrected . . . And we did make the correction with Andersen's concurrence." He says Andersen "performed limited quarterly reviews" of the company's unaudited financial statements and reviewed the entries that resulted in the shareholder-equity overstatements "to the extent they deemed necessary."

To some who follow the accounting world closely, this has a familiar ring to it. During the past few years, every Big Five auditor has been hit by multiple accounting debacles at high-profile clients. For Andersen, Enron joins a list including Waste Management Inc. and Sunbeam Corp. While the names of the clients may change, the issues remain largely the same.

For instance, Enron had reported net income of \$105 million for 1997, a figure that Enron last week said will be reduced to \$9 million in its upcoming restatement for that year. Enron said the reduction is mostly because of \$51 million in various unexplained "audit adjustments and reclassifications" that its auditors had proposed in 1997 but at the time had determined to be "immaterial." Cumulatively, those immaterial adjustments added up to nearly half of Enron's net income for 1997 and now will be included in the company's restatements.

That looks a lot like what happened at Sunbeam. According to the SEC's May settlement order with Sunbeam, Andersen auditors had routinely dismissed so many violations of GAAP as immaterial that they eventually piled up to produce significant distortions in Sunbeam's financial statements, making the barely solvent consumer-products maker look handsomely profitable. Sunbeam filed for Chapter 11 bankruptcy-court protection this past February. In May, the SEC filed a civil lawsuit against five former Sunbeam executives and the Andersen partner in charge of

the company's audit, accusing them of engaging in a massive financial fraud; all six defendants have denied the SEC's allegations. Andersen itself wasn't named as a defendant and has said it believes the lawsuit against its partner was an unjustified action over questions of professional judgment.

Under GAAP, misstatements aren't immaterial simply because they fall beneath a numerical threshold, according to an SEC accounting bulletin. Under certain circumstances -- and it remains to be seen if they apply in the Enron case -- the SEC says intentional immaterial misstatements are unlawful. One reason is that when immaterial misstatements are combined with other misstatements, they can "render the financial statements taken as a whole to be materially misleading."

Enron, which paid Andersen \$25 million last year in audit fees and \$27 million for other services, is one of Andersen's biggest clients. So far, Mr. Tabolt, the Andersen spokesman, says the SEC hasn't told Andersen it is a subject of the Enron probe.

Enron's disavowal of its previous financial statements also is a major embarrassment for the directors who sit on the Enron board's audit committee, which serves as the overseer of Enron's financial reporting, internal controls and compliance processes. Among the committee members is Wendy Gramm, a former chairman of the Commodity Futures Trading Commission and the wife of U.S. Sen. Phil Gramm (R., Texas). Ms. Gramm also was a member of the audit committee of IBP Inc., a meatpacking company that earlier this year became engulfed in an accounting debacle that prompted an SEC investigation and nearly derailed Tyson Foods' since-completed plan to buy the company.

Enron last week said its audit committee had been responsible for conducting annual reviews of the transactions between Enron and the partnerships run by former Chief Financial Officer Andrew S. Fastow. The company said its special committee is investigating "whether those controls and procedures were properly implemented." Through an Enron spokeswoman, Ms. Gramm declined to comment.

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January 17, 2002 Thursday FINAL EDITION

SECTION: FRONT; Pg. 1A

LENGTH: 1351 words

HEADLINE: **FLORIDA'S LAST-MINUTE ENRON STOCK BUYS PROBED**

BYLINE: JOHN DORSCHNER, jdorschner@herald.com

BODY:

In the tangled web of suspicions resulting from the collapse of Enron, Florida officials are trying to determine whether an investment firm with links to Enron acted improperly when it made ill-timed purchases in the energy company's stock that resulted in a \$306 million loss for the state pension fund.

The concerns focus on Alliance Capital Management, a major New York financial firm. One of its executives was Frank Savage, who was also a board member of Enron and a major contributor to political campaigns.

Altogether, Alliance bought 7.6 million Enron shares for the Florida fund, including 2.7 million shares after Oct. 22, when it was announced that the U.S. Securities and Exchange Commission was investigating the Houston company. Alliance paid from \$82 to \$9 for the shares.

It sold all 7.6 million for 28 cents a share on Nov. 30, two days before Enron declared bankruptcy.

"We've been investigating," said Coleman Stipanovich, deputy executive director of the Florida State Board of Administration, which oversees the \$96 billion pension fund.

"If Alliance did anything improper or was unduly influenced by Savage, we could sue Alliance, but we have made no decision on that."

The staff of the state board terminated Alliance in early December.

"It was a general performance issue. Enron was the straw that broke the camel's back," Stipanovich says. "Over the past several years, their performance had fallen off, and they had been on an informal watch list since mid-summer."

#### DENIALS

Alliance has repeatedly denied any wrongdoing. Savage did not return two phone calls seeking a response.

Whatever the underlying motivation, Alliance's purchases of Enron was clearly a bad investment for the Florida Retirement System, which serves 650,000 employees, including public school teachers and county employees.

In November 2000, Alliance Capital started its string of purchases by paying \$78 a share. As the stock value sank, Alliance's purchases increased. Altogether, it bought 4.9 million shares since August, when Enron Chief Executive Jeffrey Skilling abruptly resigned.

It kept buying after Oct. 17, when the company revealed that its assets were overstated by at least \$1 billion and that it had set up obscure partnerships with its own executives.

On Oct. 22, the day that it was announced that the U.S. Securities and Exchange Commission would investigate Enron, Alliance purchased 311,000 shares at \$22.82. On Oct. 24, the day that Enron's chief financial officer, Andrew Fastow, beneficiary of several partnerships, was fired, Alliance bought 302,500 shares at \$16.30.

#### MORE SHARES

After that, as the bad news mounted, Alliance bought two million more shares for the Florida pension fund. Its last purchase was Nov. 16, two weeks before Enron filed for bankruptcy.

Alliance was also buying Enron for other major clients. At one point, it had purchased more than 40 million shares.

Stipanovich says that near the end of this odyssey state officials learned that an Alliance executive was on Enron's board.

In early December, Alfred Harrison, vice chairman of the 4,440-employee Alliance, flew to Tallahassee to meet with the upset staff of the state board. "We wanted to give Al a chance to talk about his performance and Enron," says Stipanovich.

In a meeting that lasted well over an hour, Harrison said that Savage had no influence in purchasing the Enron stock, which was done for purely financial reasons.

On Dec. 5, Harrison wrote a letter to the Florida board, saying Alliance considered Enron a good investment because it held a "dominant [45 percent] position in the newly deregulated area of the wholesale gas and electricity trading market."

Harrison pointed out that many stock analysts continued to recommend Enron well into October, when the company's problems began erupting in public.

#### FREQUENT VISITS

Enron representatives came to Alliance offices to promote the stock about 10 times in the past year, Harrison wrote. Enron never mentioned that it was using its officers' partnerships to keep billions of debt off its financial books.

"Analysts and portfolio managers must make the assumption that audited financial statements are not deficient through the nondisclosure of pertinent off balance sheet items and the details of private partnerships," Harrison wrote.

Harrison added that Alliance remained enthusiastic even in November, because Dynegy, a another Texas energy company, had offered to buy Enron.

Savage was not mentioned in the two-page letter.

A spokesman for Alliance Capital says the company can no longer speak on the record about its Enron dealings because several lawsuits have been filed against the company concerning the Savage connection. But in the past, Alliance has said that Savage was chairman of its international division, serving clients in the Middle East and Africa, and had no role in stock purchases.

#### LEFT THE COMPANY

Alliance has said that Savage left Alliance in early August - before it started its rapid purchase of 4.9 million shares of Enron.

Savage, 62, now operates his own investment company, Savage Holdings, in New York. He has also served on the boards of Lockheed Martin, Qualcomm and Bloomberg LP. He is a trustee at Howard and Johns Hopkins universities.



Savage has long been a major contributor to Democratic candidates. During his three years on the Enron board, Savage has given at least \$125,000 to politicians and the Democratic Party, according to the records of the Center for Responsive Politics, a nonpartisan watchdog group in Washington.

Critics have pointed out that Enron's board was loaded with politically connected persons. Just for the 2000 election, Enron and its executives contributed \$2.4 million to candidates and parties nationwide. In recent years, Florida politicians have received \$200,000 from Enron. The company gave Gov. Jeb Bush at least \$5,000 for his 1998 gubernatorial campaign.

#### GOVERNOR'S ROLE

Bush is one of three members on the board of trustees that oversees the state pension fund, but Stipanovich says the governor was never involved in the selection of Alliance, the purchase of Enron stock or the decision to terminate its contract.

Elizabeth Hirst, spokeswoman for the governor, said "there is no linkage" between Bush and Alliance's purchase of the stock.

Stipanovich emphasized that the \$300 million lost in the Enron investment accounted for less than 1 percent of the state's \$96 billion pension fund. No one receiving a pension will be affected because the fund provides defined benefits, guaranteed by the state. Alliance was one of 70 money managers the state uses for the fund.

#### Pension investments in Enron

Florida's pension plan for public employees lost more than \$300 million when one of its investment companies kept buying shares in Enron even after the Texas company's problems began to surface.

Aug. 14: Enron CEO Jeffrey Skilling resigns shares close at \$42.93.

Oct. 17: Enron announces \$1.2 billion in losses tied to transactions involving CFO Andrew Fastow shares close at \$32.20.

Oct. 22: SEC investigation announced; Florida pension buys 311,200 shares at \$22.82.

Oct. 24: Fastow is ousted shares close at \$16.41. Florida pension buys 302,500 shares at \$16.30.

Oct. 25: Florida pension buys 124,600 shares at \$15.47.

Oct. 29: Florida pension buys 373,900 shares at \$14.51.

Oct. 30: Florida pension buys 317,800 shares at \$12.23.

Nov. 8: Enron admits it overstated profits by \$568 million over the previous five years shares close at \$8.41.

Nov. 13: Florida pension buys 581,900 shares at \$9.37.

Nov. 14: Florida pension buys 478,600 shares at \$9.84.

Nov. 16: Florida pension buys 209,500 shares at \$9.02.

Nov. 28: Dynegy merger collapses shares close at 61 cents.

Nov. 30: Florida pension sells 7,583,900 shares at 28 cents.

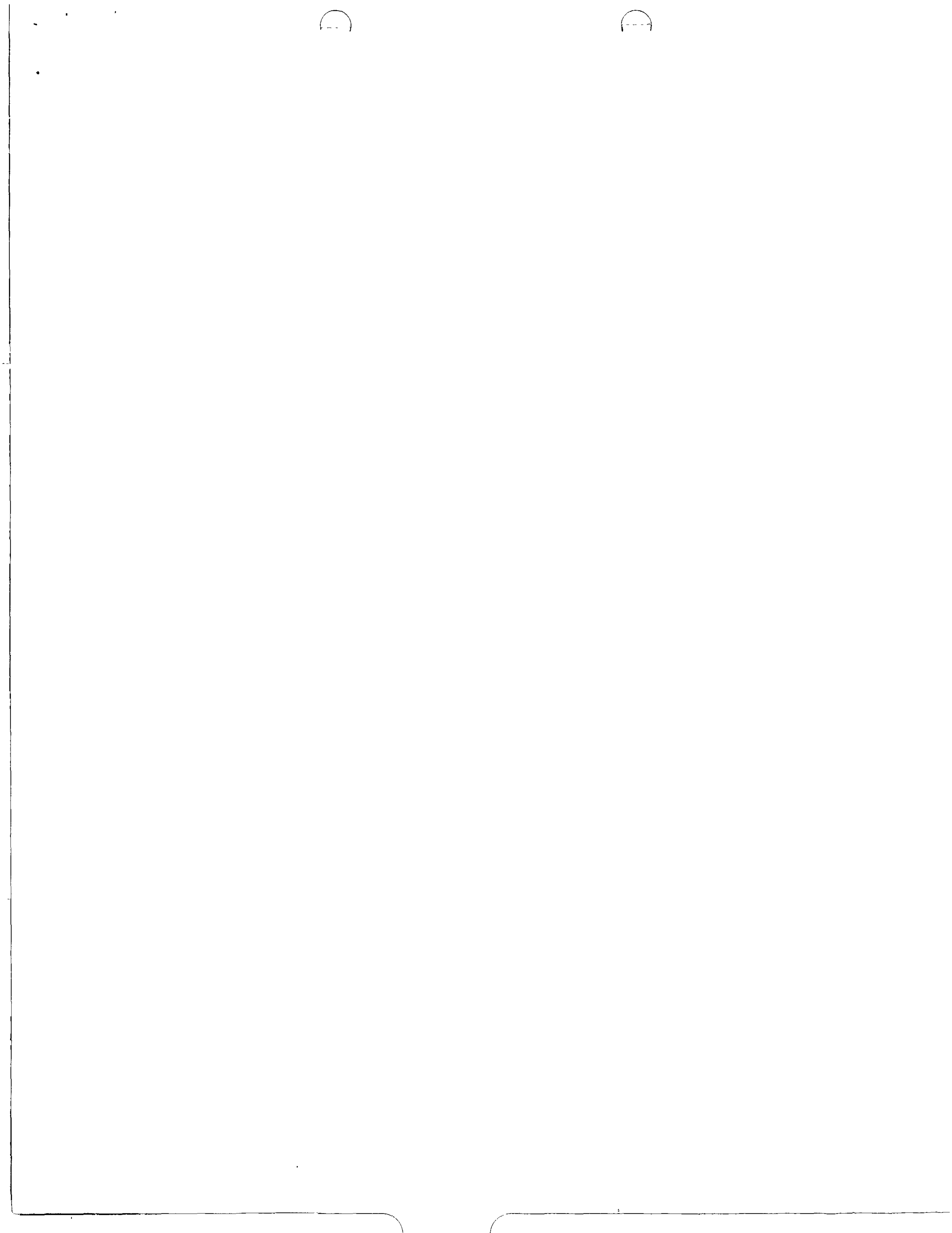
Dec. 2 (Sunday): Enron files bankruptcy shares close at 40 cents on Monday, Dec. 3.



SOURCE: State of Florida

GRAPHIC: chart: Pension Investments in Enron

LOAD-DATE: January 18, 2002



# 21

Leonard Barrack (LB-0355)  
 Sheldon L. Albert (SA-2506)  
 Jeffrey W. Golan (JG-8892)  
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**FILED**

JUL 2 2001

AT 8:30  
 WILLIAM T. WALSH  
 CLERK

2001 JUL -2 P 12:17

UNITED STATES

-and-

Robert A. Hoffman (RH-7317)  
 Samuel R. Simon (SS-8761)  
**BARRACK, RODOS & BACINE**  
 14 Kings Highway West  
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 (856) 354-0707

**ENTERED**ON  
THE DOCKET

JUL 3 2001

WILLIAM T. WALSH, CLERK

By \_\_\_\_\_  
(Deputy Clerk)

Attorneys for the Florida State  
 Board of Administration and  
 Proposed Lead Counsel for the Class

**UNITED STATES DISTRICT COURT  
 FOR THE DISTRICT OF NEW JERSEY**

MARVIN MYERS, individually and  
 on behalf of all others similarly situated,

Plaintiff,

v.

SCHERING-PLOUGH CORPORATION;  
 RICHARD J. KOGAN; and THOMAS H.  
 KELLY,

Defendants.

Civil Action No.  
 2:01-CV-829 (KSH/RJH)

~~**[PROPOSED] ORDER APPOINTING LEAD PLAINTIFF AND LEAD COUNSEL**~~

**Exhibit 5**



**WHEREAS:**

The above-captioned matter and numerous other related actions have been brought as securities class actions against Schering-Plough Corporation ("Schering-Plough") and certain individuals under the Private Securities Litigation Reform Act of 1995 ("PSLRA"); and

**WHEREAS:**

On April 17, 2001, five parties, Bridgewater Partners ("Bridgewater"), Thomas A. Endicott ("Endicott"), Florida State Board of Administration ("FSBA"), Laborers District Council Construction Industry Pension Fund ("Laborers District Council"), and Rongelap Claims TR Rittenhouse Fund ("Rongelap"), filed respective motions for appointment as lead plaintiff pursuant to the PSLRA, 15 U.S.C. § 78u-4(a)(3)(B), in this action and all other related actions; and

**WHEREAS:**

Bridgewater and Rongelap subsequently withdrew their motions and supported the motion of FSBA, while Laborers District Council also expressed its support for FSBA's motion; and

**WHEREAS:**

FSBA, in support of its motion, contended that it was "most adequate plaintiff" as defined by the PSLRA, 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I), having sustained a loss of more than \$27 million in connection with its purchases of Schering-Plough stock; and

**WHEREAS:**

Endicott, an individual investor, claimed to have sustained a loss of approximately \$1 million in connection with his purchases of Schering-Plough stock; and

**WHEREAS:**

Endicott, in opposition to the lead plaintiff motion of FSBA, contended that FSBA should be precluded from serving as a lead plaintiff in this matter under the terms of the PSLRA's "restrictions

on professional plaintiffs," 15 U.S.C. § 78u-4(a)(3)(B)(vi), because it has served as a lead plaintiff in more than five other securities class action during the past three years. Endicott also contended that the calculation of FSBA's losses was incorrect and that FSBA's sales of Schering-Plough stock during the relevant period could subject it to "unique defenses;" and

**WHEREAS:**

FSBA is an institutional investor that administers over \$105 billion in assets of the Florida Retirement System and a myriad of other state and local funds, serving approximately 800,000 beneficiaries comprised of over 600,000 active members and 170,000 retirees; and

**WHEREAS:**

FSBA, in response to the arguments of Endicott, contended, *inter alia*, that both the language of the statute and legislative history demonstrated that the PSLRA's five cases in three years restrictions on professional plaintiffs are not intended to apply to institutional investors. FSBA further contended that its experience as a lead plaintiff in other securities class actions, its administration of pension funds on behalf of hundreds of thousands of beneficiaries and its legal staff and other professional employees would enhance its representation of a class in this matter. FSBA further contended that its sales of Schering-Plough securities during the relevant period would not subject it to "unique defenses" and that its losses were determined correctly using the first-in, first out ("FIFO") method of calculation; and

**WHEREAS:**

On June 11, 2001, the Court held a hearing to consider the lead plaintiff motions, at which time counsel for FSBA and counsel for Endicott appeared and presented argument.

NOW THEREFORE, this 22 day of July, 2001, based upon the memoranda and affidavits submitted by the movants, the arguments presented and for the reasons appearing on the







IN THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION

In re NCI BUILDINGS SYSTEMS, §  
INC. SECURITIES LITIGATION §

MASTER FILE NO.  
H-01-1280

CHAVY WEISZ, on behalf of §  
himself and all others similarly §  
situated, §

Plaintiff §

VS. §

CIVIL ACTION NO. H-01-1280

NCI BUILDING SYSTEMS, INC., §  
ALBERT R. GINN, JOHNIE SCHULTE, §  
JR., ROBERT J. MEDLOCK, DENNETH §  
W. MADDOX, AND DONNIE R. §  
HUMPHRIES, §

Defendants §

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF TEXAS  
ENTERED

DEC 28 2001

ROBERT STANLEY, on behalf of §  
himself and all others similarly §  
situated, §

Plaintiff, §

VS. §

CIVIL ACTION NO. H-01-1281

NCI BUILDING SYSTEMS, INC., §  
JOHNIE SCHULTE, JR., AND ROBERT §  
MEDLOCK, §

Defendants §

Michael N. Milby, Clerk

LILIANE RICHMAN IRA, on behalf §  
of itself and all others §  
similarly situated, §

Plaintiff, §

VS. §

CIVIL ACTION NO. H-01-1304

NCI BUILDING SYSTEMS, INC., §  
JOHNIE SCHULTE, JR., AND ROBERT §  
MEDLOCK, §

Defendants §

CARL A. KOFFLER, on behalf of §  
himself and all others similarly §  
situated. §

Plaintiff, §

VS. §

CIVIL ACTION NO. H-01-1319

NCI BUILDING SYSTEMS, INC., §  
A.R. GINN, JOHNIE SCHULTE, JR., §  
DONNIE R. HUMPHRIES, ROBERT J. §  
MEDLOCK, AND KENNETH MADDOX, §

Defendants §

---

MICHELLE GOLOMBUSKKI, on behalf §  
of herself and all others §  
similarly situated, §

VS. §

CIVIL ACTION NO. H-01-1331

NCI BUILDING SYSTEMS, INC., §  
ALBERT R. GINN, JOHNIE SCHULTE, §  
JR., ROBERT J. MEDLOCK, DENNETH §  
W. MADDOX, AND DONNIE R. §  
HUMPHRIES, §

Defendants §

---

TOM MINNICH, on behalf of §  
himself and all others similarly §  
situated, §

VS. §

CIVIL ACTION NO. H-01-1340

NCI BUILDING SYSTEMS, INC., §  
JOHNIE SCHULTE, JR., AND ROBERT §  
J. MEDLOCK, §

Defendants §

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TARA FOUTS, on behalf of herself\$  
and all others similarly \$  
situated, \$

VS.

CIVIL ACTION NO. H-01-1437

NCI BUILDING SYSTEMS, INC., \$  
JOHNIE SCHULTE, JR., AND ROBERT \$  
J. MEDLOCK, \$

Defendants

PETER DALY, on behalf of himself  
and all others similarly  
situated,

VS.

CIVIL ACTION NO. H-01-1454

NCI BUILDING SYSTEMS, INC., §  
ALBERT R. GINN, JOHNIE SCHULTE, §  
JR., ROBERT J. MEDLOCK, DENNETH §  
W. MADDOX, AND DONNIE R. §  
HUMPHRIES, §

## Defendants

DARLENE LYNDES, on behalf of       \$  
herself and all others similarly\$  
situated,                               \$

VS.

CIVIL ACTION NO. H-01-1593

NCI BUILDING SYSTEMS, INC., \$  
ALBERT R. GINN, JOHNIE SCHULTE, \$  
JR., ROBERT J. MEDLOCK, DENNETH \$  
W. MADDOX, AND DONNIE R. \$  
HUMPHRIES, \$

## Defendants

PAUL SALMORE, on behalf of §  
himself and all others similarly §  
situated, §

VS.

CIVIL ACTION NO. H-01-1876

NCI BUILDING SYSTEMS, INC., \$  
JOHNIE SCHULTE, JR., AND ROBERT \$  
J. MEDLOCK, \$

## Defendants

## ORDER

Pending before the Court in the above referenced, consolidated, proposed class action on behalf of investors who purchased securities of Defendant NCI Building Systems, Inc. ("NCI") from August 25, 1999 through April 12, 2001 (the "Class Period"), alleging violations of federal securities laws, are (1) Joseph and Delores Young ("the Youngs") and Craig Doerge (IRA)'s ("Doerge's") unopposed motion (instrument #5) for appointment of themselves as Lead Plaintiffs, and for approval of Bernstein, Liebhard & Lifshitz, L.L.P. and Milberg Weiss Hynes Bershad & Lerach L.L.P. as Co-Lead Counsel, and of Hoeffner, Bilek & Eidman, L.L.P. as Liaison Counsel, pursuant to Section 21D(a)(3)(B)(v) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78u-4(a)(3)(B)(v), as amended by the Private Securities Litigation Reform Act of 1995 ("PSLRA"); and (2) Liliane Richman's ("Richman's") motion to appoint her Lead Plaintiff and the firm of Pomerantz Haudek Block & Gross LLP as Lead Counsel, and Burt Barr Havins & O'Dea, LLP as Liaison Counsel (instrument #7 in H-01-1304). In light of the responses filed by counsel for various Plaintiffs to the Court's last order, it appears that these individual Movants are the only investors seeking to be appointed with their law firms as Lead Plaintiff(s), Lead Counsel and Liaison counsel, and that no institutional investor has come forward.

### **Applicable Law**

Under 15 U.S.C. § 78u-4(a)(3)(B)(i) of the PSLRA, which amended the Securities Exchange Act of 1934 by adding Section 21D,

15 U.S.C. § 78u-4, in class actions brought under federal securities laws, "the court shall consider any motion made by a purported class member" in determining the adequacy of a proposed lead plaintiff to oversee the class action. Furthermore, "the presumption [of the adequacy of the plaintiff with the largest financial interest<sup>1</sup> in the outcome of the litigation] described in [15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)] may be rebutted only upon proof by a member of the purported plaintiff class that the proposed individual or entity will not fairly and adequately protect the interests of the class or that he/she/or it is subject to unique defenses that render [him/her/or it] incapable of adequately representing the class." 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II).

Based on the express language of the statute, courts have concluded that defendants lack standing to challenge the adequacy or typicality of the proposed lead plaintiffs at this early stage of the litigation. See, e.g., Takeda v. Turbodyne Technologies, Inc., 67 F. Supp.2d 1129, 1138 (C.D. Cal. 1999); Gluck v. CellStar Corp., 976 F. Supp. 542, 550 (N.D. Tex. 1997); Greebel v. FTP Software, Inc., 939 F. Supp. 57, 60-61 (D. Mass. 1996); Fischler

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<sup>1</sup> The PSLRA does not delineate a procedure for determining the "largest financial interest" among the proposed class members. A four-factor inquiry has been developed by the district court in Lax v. First Merchants Acceptance Corp., 1997 WL 461036, \*5 (N.D. Ill. Aug. 11, 1997), and recognized in In re Olsten Corp. Securities Litigation, 3 F. Supp.2d 286, 295 (E.D.N.Y. 1998). and in In re Nice Securities Litigation, 188 F.R.D. 206, 217 (D.N.J. 1999). The four factors relevant to the calculation are (1) the number of shares purchased; (2) the number of net shares purchased; (3) the total net funds expended by the plaintiffs during the class period; and (4) the approximate losses suffered by the plaintiffs. Id.



v. AmSouth Bancorporation, 1997 WL 118429, \*2 (M.D. Fla. 1997); Zuckerman v. Foxmeyer Health Corp., 1997 WL 314422, \*2 (N.D. Tex. 1997). The Court observes that while defendants lack standing to challenge plaintiffs' motions to appoint certain among them as Lead Plaintiff, defendants do have the right subsequently in a class certification hearing to object to those Plaintiffs as typical of and adequate representatives of the proposed class. In re Nice Systems Securities Litig., 188 F.R.D. 206, 218 n.11 (D.N.J. 1999); Zuckerman, 1997 WL 314422 at \*2); Gluck, 976 F. Supp. at 547); Greebel, 939 F. Supp. at 60-61; In re Cephalon Securities Litig., 1996 WL 515203 (E.D. Aug. 27, 1996). Furthermore, this Court may sua sponte evaluate the adequacy of any proposed person or group of persons as Lead Plaintiff(s). Takeda, 67 F. Supp. at 1138; Sakhrani, 78 F. Supp.2d at 854 (court has independent responsibility to consider appointment of lead counsel). It is clear that "[t]he PSLRA calls for greater supervision by the Court in the selection of which plaintiffs will control the litigation." In re Oxford Health Plans, Inc. Securities Litigation, 182 F.R.D. 42, 45 (S.D.N.Y. 1998).

Under the relevant portions of 15 U.S.C. § 78u-4(a)(3)(A)(i) and (iii)(I), after national notice<sup>2</sup> of the pending

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<sup>2</sup> Under § 21D of the Exchange Act, 15 U.S.C. § 78u-4(a)(3)(A)(i), a plaintiff seeking to represent the class

shall cause to be published in a widely-circulated national business-oriented publication or wire service, a notice advising members of the purported class--

(I) of the pendency of the action, the claims asserted therein, and the purported

proposed class action by a plaintiff within twenty days of plaintiff's filing of a class complaint, any member of the putative class may file within sixty days of the publishing of that notice a motion to serve as Lead Plaintiff. 15 U.S.C. § 78u-4(a)(3)(A). If more than one suit is filed with substantially the same claims, only the plaintiff in the first-filed action need publish the notice. 15 U.S.C. § 78u-4(a)(3)(A)(ii).

After consolidation of parallel actions, under the PSLRA a district court

shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members (hereafter in this paragraph referred to as the "most adequate plaintiff") in accordance with this subparagraph.

Furthermore, Section 21D(a)(3)(B) of the amended Securities

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class period;

(II) that, not later than 60 days after the date on which the notice is published, any member of the purported class may move the Court to serve as lead plaintiff of the purported class.

Thus being first to file a complaint is no longer a guarantee of the lead plaintiff position. Section 21(D)(a)(3)(B)(i), 15 U.S.C. § 78u-4(a)(3)(B)(i) provides,

Not later than 90 days after the date on which a notice is published . . . the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the complaint or complaints, and shall appoint as lead plaintiff the member or members of the purported plaintiff class that the class determines to be most capable of adequately representing the interests of the class member . . . .

Exchange Act of 1934 requires the Court to adopt a rebuttable presumption that

the most adequate plaintiff in any private action arising under this chapter is the person or group of persons that

(aa) has either filed the complaint or made a motion in response to a notice . . . ;

(bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

15 U.S.C. § 78u-4(a)(3)(B)(iii)(I). The statutory presumption of appointment as lead plaintiff, as noted, may only be rebutted by another plaintiff through evidence that the lead plaintiff "will not fairly and adequately protect the interests of the class" or is "subject to unique defenses that render such plaintiff incapable of adequately representing the class." 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II).

Under Section 21D(a)(3)(B) of the Exchange Act, therefore, the lead plaintiff or plaintiffs must possess not only the largest financial interest in the outcome of the litigation, but must also meet the requirements of Federal Rule of Civil Procedure 23. Rule 23(a) provides that a party may serve as a class representative only if the following four requirements are met:

(1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and



adequately protect the interests of the class.

Typicality is achieved where the named plaintiffs' claims arise "from the same event or course of conduct that gives rise to claims of other class members and the claims are based on the same legal theory." Longden v. Suderman, 123 F.R.D. 547, 556 (N.D. Tex. 1988). Typicality and adequacy are directly relevant to the choice of the class representative and Lead Plaintiff in securities fraud cases. See, e.g., In re Oxford Health Plans, Inc. Securities Litig., 182 F.R.D. 42, 49 (S.D.N.Y. 1998); Gluck, 976 F. Supp. at 546; Fischler, 1997 WL 118429 \*2. Although the inquiry at this stage of the litigation in determining the Lead Plaintiff is not as searching as the one triggered by a subsequent motion for class certification, the proposed Lead Plaintiff must make at least a preliminary showing that it has claims that are typical of those of the putative class and the capacity to provide adequate representation for those class members. Switzenbaum v. Orbital Sciences Corp. ("Orbital I"), No. 99-197, slip op. at \*10 (E.D. Va. May 21, 1999) (Compendium (#Ex. F), citing Chill v. Green Tree, 181 F.R.D. 398, 407 n.8 (D. Minn. 1998), and Lax v. First Merchants Acceptance Corp., 1997 WL 461036, \*6 (N.D. Ill. Aug. 11, 1997).

Under the PSLRA, the Lead Plaintiff, subject to court approval, is to select and retain Lead Counsel. 15 U.S.C. § 78u-4(a)(3)(B)(v). The Court should not disturb the Lead Plaintiff's choice of counsel unless it is necessary to "protect the interests of the [plaintiff] class." 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II)(aa).

In passing the PSLRA in December 1995, Congress was

reacting to significant evidence of abusive practices and manipulation by class action lawyers of their clients in private securities lawsuits. H.R. Conf. Rep. No. 104-369, 104th Cong., 1st Sess. at 31 (1995), reprinted in 1995 U.S.C.A.A.N. 730 at 731 ("Conf. Report") (Ex. A to #38). One response by Congress was the requirement that the Court appoint as "lead plaintiff" in each securities class action the shareholder, preferably an institutional investor,<sup>3</sup> with the largest financial interest in the litigation in order to encourage institutional investors to come forward to manage the litigation and supervise the class action lawyers. 15 U.S.C. § 78u-4(a)(3)(B); Conf. Report No. 104-369 at 733-34. The Conference Report, at 34, explained, "Throughout the process, it is clear that the plaintiff class has difficulty exercising any meaningful direction over the case brought on its behalf . . . . Because class counsel's fees and expenses sometimes amount to one-third or more of the recovery, class counsel frequently has a significantly greater interest in the litigation than any individual member of the class." Thus one goal of the PSLRA is to have the plaintiff class, represented by a member with a substantial financial interest in the recovery as incentive, monitor the litigation to prevent its being "lawyer-driven."

In the instant consolidated action, procedural requirements have been fulfilled by Movants and counsel all appear

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<sup>3</sup> Conference Report No. 104-67 at 34-35; Sen. Rep. No. 104-98 at 10-11, reprinted in 1995 U.S.C.A.A.N. 679, 689-90. Sakhrani v. Brightpoint, 78 F. Supp.2d 845, 850 (S.D. Ind. 1999); Gluck v. CellStar Corp., 976 F. Supp. 542, 548 (N.D. Tex. 1997); In re Baan Co. Securities Litig., 186 F.R.D. 214, 218 (D.D.C. 1999) (appendix).

qualified to serve the roles requested. Richman reports losses of approximately \$2,121. Aggregated, the Youngs (a married couple) and Doerge's losses are \$17,107.50. The issues here appear to whether the Youngs and Doerge's losses ought to be aggregated and they be allowed to proceed together as Lead Plaintiffs because they have the largest financial interest in the relief sought by the class and, if so, whether appointment of their two law firms to serve as Lead Counsel is appropriate.

Courts have diverged in deciding whether the losses of individual plaintiffs may be aggregated into a group loss to create a lead plaintiff group with the "greatest financial interest" in the outcome of the litigation. Aronson v. McKesson HBOC, Inc., 79 F. Supp. 1146, 1152-53 (N.D. Cal 1999) (and cases cited therein). Some courts have read literally the statute dealing with determining who is the most adequate plaintiff, which employs the phrase, "the person or group of persons" that meet the designated criteria. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I). Id. at 1153 & n.8, citing as published opinions of courts allowing aggregation of unrelated plaintiffs into a Lead Plaintiff Group, In re Olsten Corp., 3 F. Supp.2d 286 (E.D.N.Y. 1998); Switzenbaum v. Orbital, 187 F.R.D. 246 (E.D. Va. 1999); In re Milestone Scientific, 193 F.R.D. 404 (D.N.J. 1998); In re Cendant, 182 F.R.D. 144 (D.N.J. 1998); In re Oxford, 182 F.R.D. 43; Chill v. Green Tree Financial, 181 F.R.D. 398 (D. Minn. 1998); Gluck, 976 F. Supp. 542; In re Donnkenny, Inc. Securities Litig., 171 F.R.D. 156 (S.D.N.Y. 1997); Greebel, 939 F. Supp. 57. See also Yousefi v. Lockheed Martin



Corp., 70 F. Supp.2d 1061, 1067-68 (C.D. Cal. 1999) (recognizing tension between PSLRA' language permitting aggregation of claims and its emphatic purpose of placing control of securities class actions in hands of a small and finite number of plaintiffs, but finding that it contemplates the aggregation of unrelated plaintiffs as a permissible, if suboptimal, result).

Other judges have allowed aggregation where necessary to represent varying class periods or to guarantee effective control and supervision of the lawyers. Aronson, 79 F. Supp. at 1153, citing Wenderhold v. Cylink Corp., 188 F.R.D. 577, 585-86 (N.D. Cal. 1999). See also In re Baan Co. Sec. Litig., 186 F.R.D. 214, 224 (D.D.C. 1999) ("a court generally should only approve a group that is small enough to be capable of effectively managing the litigation and the lawyers").

Some courts have rejected aggregation of "unrelated" Plaintiffs and permit a group Lead Plaintiff only where it involves "a small number of members that share such an identity of characteristics, distinct from those of almost all other class members, that they can almost be seen as being the same person." Aronson, 79 F. Supp. at 1153-54, citing In re Telxon Corp. Securities Litig., 67 F. Supp.2d 803, 809-13 (N.D. Ohio 1999) (contrasting a "group" with a "melange of unrelated persons"). Aronson characterizes this approach as defining a "group" under the PSLRA as having "a meaningful relationship preceding the litigation, and . . . united by more than the mere happenstance of having bought some securities. The classic example of such a

restrictive group would be a partnership, which has no separate legal identity, but shares in both assets and liabilities. Other such groups might be the various subsidiaries of a corporation or members of a family." Id. at 1153-54. The Aronson court, faced with groups of plaintiffs as large as 4,000 competing for lead plaintiff, adopted this strict approach. Id. at 1154. Aronson emphasizes that such a narrow view accords with several dictionary definitions of the word "group" and is consistent with the legislative intent to increase investors'/clients' control over appointed counsel, since any ambiguity in the statute should be resolved by a determination of the drafters' intent. See also In re Network Associates, 76 F. Supp.2d at 1026) (a group of plaintiffs should be appointed as lead plaintiff only where they can effectively control the litigation; aggregations of unaffiliated persons or entities whose only connection is the litigation do not satisfy this requirement); In re Donkenny Securities Litigation, 171 F.R.D. 156, 157-58 (S.D.N.Y. 1997) (denied plaintiff's motion to appoint two institutional investors and four individuals as lead plaintiff group because "[t]o allow an aggregation of unrelated plaintiffs to serve as lead plaintiffs defeats the purpose of choosing a lead plaintiff . . . . To allow lawyers to designate unrelated plaintiffs as a 'group' and aggregate their financial stakes would allow and encourage lawyers to direct the litigation."); Sakhrani, 78 F. Supp. 2d at 853 (the PSLRA gives court discretion to appoint a single plaintiff or a small group with effective oversight of class counsel and with a greater

connection than their common losing investment as lead counsel, based on facts of particular case).

The burden is on those seeking to aggregate to demonstrate the cohesiveness of their purported "group" and that failure to provide significant information about the identity of the members other than a conclusory statement of names, transactions for purchase of securities, and largest financial interest should result in denial of their application for appointment as Lead Plaintiff. Switzenbaum v. Orbital Sciences Corp. ("Orbital I"), No. 99-197, slip op. at 10-11 (E.D. Va. May 21, 1999) (Compendium (#Ex. F); Ravens v. Iftikar, 174 F.R.D. 651, 654 (N.D. Cal. 1997). Furthermore, the SEC in an amicus curiae brief filed in the Orbital litigation, Compendium Ex. G at p. 14, made clear that a group of plaintiffs should be quite small: "The Commission believes that ordinarily, in order to ensure adequate stakes, monitoring, coordination and accountability, such a group should be no more than three to five persons, and the fewer the better." Even then, the SEC emphasizes that the group's "members should be evaluated separately for their incentive and ability to work together to control the litigation." Id.

It appears to this Court that too loose a definition of "group" would result in the manipulation and manufacturing of large groups of unrelated investors by attorneys in order to obtain appointment of an uncohesive, disparate, and thus weakened, group of Lead Plaintiffs and approval of themselves as Lead Counsel, a lucrative role. Sakhrani, 78 F. Supp.2d at 851-52 (and cases cited



therein); In re Network Associates, 76 F. Supp. at 1022.

After a careful review of the case law, this Court finds that the strictest approach, requiring one Lead Plaintiff or at maximum a small group with the largest financial interest in the outcome of the litigation and, if more than one, a pre-litigation relationship based on more than their losing investments, satisfies the terms of the PSLRA and serves the purpose behind its enactment.

It is evident that either the Youngs or Doerge, or both, have greater losses than Richman. Nevertheless despite substantial opportunity and the express concern of the Court about identifying the most adequate plaintiff, the Youngs as a unit, since they are related, and Doerge have not met their burden of proof by identifying any prior relationship between them, nor have they indicated specifically what sum the Youngs lost and what sum Doerge lost. Furthermore, given the relatively small amounts of money lost by named Plaintiffs in this action in comparison with those lost by most other securities fraud litigants, the Court finds questionable the need for more than one firm to serve as Lead Counsel. Accordingly, the Court

ORDERS that Richman's motion is DENIED and the Youngs and Doerge's motion is GRANTED to the following extent. The Youngs and Doerge shall within five days file a statement with the Court, to be served on all parties, as to the sums lost by each. Whichever's loss is greater shall serve as Lead Plaintiff(s). As indicated, the Youngs qualify as a related group and may proceed as co-Lead Plaintiffs if their loss is greater than that of Doerge. Moreover,

whichever is then designated Lead Plaintiff(s), they or he shall designate one law firm, which shall serve as Lead Counsel and one firm as Liaison Counsel. Moreover, the Court

ORDERS that the firm designated as Lead Counsel shall file an amended complaint on behalf of the class by February 1, 2002. Defendants shall file a responsive pleading, which they have previously indicated will be a motion to dismiss, by March 15, 2002. Plaintiffs shall have until April 30, 2002 to respond.

SIGNED at Houston, Texas, this 22<sup>th</sup> day of December, 2001.



MELINDA HARMON  
UNITED STATES DISTRICT JUDGE





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FILED  
WILLIAM T. WALSH, CLERK

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**FILED**

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AT 8:30  
WILLIAM T. WALSH  
CLERK**UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF NEW JERSEY**

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**PATRICIA BENAK, on behalf of ALLIANCE  
PREMIER GROWTH FUND,**

Plaintiff,

v.

**ALLIANCE CAPITAL MANAGEMENT L.P.**

Defendant,

CASE NO. 01cv5734 (WB)

**JURY TRIAL DEMANDED**

-and-

**ALLIANCE PREMIER GROWTH FUND,**

Nominal Defendant.

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**COMPLAINT**

Plaintiff, on behalf of the Alliance Premier Growth Fund, by her undersigned counsel, alleges the following upon personal knowledge as to her own acts, and upon information and belief based on the investigation conducted by her counsel as to all other allegations:

### NATURE OF THE ACTION

Pursuant to Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35(b), plaintiff brings this action on behalf of the Alliance Premier Growth Fund, "Series A," "Series B," "Series C," and the "Advisor Class Series," (collectively hereinafter the "Premier Growth Fund") to recover the investment advisory fees paid by the Premier Growth Fund to its investment adviser, Alliance Capital Management L.P., during the prior 12 month period immediately preceeding the institution of this action, in breach of the adviser's fiduciary duty in respect of such compensation.

### JURISDICTION AND VENUE

1. This action arises under Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35 (the "Investment Company Act").
2. The jurisdiction of this Court is based on Section 36(b) of the Investment Company Act and 28 U.S.C. § 1331 (federal question jurisdiction).
3. Venue is proper in this District as the Premier Growth Fund maintains its principal place of business at 500 Plaza Drive 3<sup>rd</sup> Floor, Seacaucus, New Jersey 07094 and many of the acts, transactions and wrongful conduct alleged herein occurred in substantial part in this District.

### THE PARTIES

#### Plaintiff

4. Plaintiff Patricia Benak ("Benak") purchased approximately 250 shares of the Premier Growth Fund in June 2000 and continues to own such shares.

#### Defendant

5. Alliance Capital Management L.P., (hereinafter the "Adviser") at all times

relevant hereto, was and continues to serve as, the investment adviser to the Alliance Premier Growth Fund. Acting in its capacity as investment adviser to the Alliance Premier Growth Fund, the Adviser provided investment advice to the Alliance Premier Growth Fund and was compensated therefor. Pursuant to 15 U.S.C. § 80a-35(b), as an investment adviser to the Alliance Premier Growth Fund, the Adviser owed a statutorily imposed fiduciary duty to the Premier Growth Fund with respect to the receipt of compensation for services. As set forth in detail below, the Adviser breached this fiduciary duty and caused the Premier Growth Fund to incur hundreds of millions of dollars in damages as a result of such breach.

6. According to the Schedule 14A filed with the United States Securities and Exchange Commission ("SEC") by Enron Corp. (hereinafter "Enron") dated March 28, 2000, at all times relevant hereto, Mr. Frank Savage "Savage" served as a Director of the Adviser and thereby owed the Adviser a fiduciary duty of loyalty. In addition, according to the same proxy statement, during all times relevant hereto, Savage also served as a Director of Enron.

#### Nominal Defendant

7. Alliance Premier Growth Fund is a registered investment company under the Investment Company Act of 1940, 15 U.S.C. § 80a-1, et seq. According to the Alliance Premier Growth Fund Semi-Annual Report dated May 31, 2001, "under the terms of an investment advisory agreement, the Fund pays [the Adviser] an advisory fee equal to the annualized rate of 1.00% of the Fund's average daily net assets up to \$5 billion, .95% of the next \$2.5 billion of the Fund's average daily net assets, .90% of the next \$2.5 billion of the Fund's average daily net assets, and .85% of the Fund's average daily net assets over \$10 billion. Such fee is accrued daily and paid monthly." The Alliance Premier Growth Fund paid the Adviser investment adviser fees of approximately \$140 million during the twelve month period immediately



preceding the filing of this action. By virtue of the Adviser's breach of fiduciary duty as specifically alleged below, the Premier Growth Fund incurred hundreds of millions of dollars in damages.

### **SUBSTANTIVE ALLEGATIONS**

#### **The Enron Fraud**

8. Enron is a corporation organized and existing under the laws of the State of Oregon with principal corporate offices located in Houston, Texas. Enron provides products and services related to natural gas, electricity and communications to wholesale and retail customers. Enron's operations are conducted through its subsidiaries and affiliates, which are principally engaged in the: (i) transportation of natural gas through pipelines to markets throughout the United States; (ii) generation, transmission and distribution of electricity to markets in the northwestern United States; (iii) marketing of natural gas, electricity and other commodities and related risk management and finance services worldwide; (iv) development, construction and operation of power plants, pipelines and other energy related assets worldwide; (v) delivery and management of energy commodities and capabilities to end-use retail customers in the industrial and commercial business sectors; and (vi) development of an intelligent network platform to provide bandwidth management services and the delivery of high bandwidth communication applications. Enron common stock is actively traded on the New York Stock Exchange under the symbol "ENE."

9. Frank Savage is, and has been, an Enron director since 1999. Mr. Savage has also simultaneously served as a Director of Alliance Capital Management L. P., the Adviser to the Premier Growth Fund. In addition, Savage has also served as Chairman of Alliance Capital Management International, a division of Alliance Capital Management L.P..

10. On October 16, 2001, Enron announced that it was taking a \$1.01 billion charge mostly connected with write-downs of soured investments, producing a \$618 million third-quarter loss.

11. On October 17, 2001, the Wall St. Journal reported that, while the mere size of the \$1 billion plus dollar charge had raised questions on Wall Street, analysts were more concerned with the fact that \$35 million of the charge stemmed from losses incurred by "a pair of limited partnerships that until recently were run by Enron's chief financial officer." In making the announcement, Enron commented that "the charge connected with the partnerships is \$35 million and involves the 'early termination . . . of certain structured finance arrangements.'"

According to the Wall St. Journal, "two years ago, [Enron's] chief financial officer, Andrew S. Fastow, entered into the unusual arrangement with his employer. With the approval of the board of Enron, Mr. Fastow set up and ran the partnerships that stood to make him millions or more, according to partnership documents." (Emphasis added).

12. As reported, "the two partnerships, LJM Cayman LP and the much larger LJM2 Co-Investment LP, have engaged in billions of dollars of complex hedging transactions with Enron involving company assets and millions of shares of Enron stock."

13. Mr. Fastow's role as chief financial officer made him privy to internal asset analyses at Enron. An offering memorandum for the LJM2 Co-Investment, L.P. ("LJM2") partnership said that this dual role "should result in a steady flow of opportunities . . . to make investments at attractive prices."

14. Incredibly, the document went so far as to expressly acknowledge the glaring conflict of interest that existed under this agreement and the multi-million dollar incentive for Fastow to engage in self-dealing to the detriment, and at the expense of, Enron and its stockholders



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to whom he and Enron's Board of Directors owed a fiduciary duty and states that this dual role "should result in a steady flow of opportunities . . . to make investments at attractive prices and that Mr. Fastow would find his interests "aligned" with investors because the "economics of the partnership would have significant impact on the general partner's [Mr. Fastow's] wealth." (Emphasis added).

15. In late July, 2001, Mr. Fastow severed his relations with the partnerships, according to an Enron SEC filing. Enron officials said that move was partly related to questions raised by analysts and large Enron shareholders. And it has recently been reported that the partnerships have been liquidated, or are in the process of being liquidated.

16. Little about the inner workings of the LJM partnerships has been disclosed to date. Private partnership documents indicate that Enron agreed to a partnership arrangement with potentially huge financial rewards for Mr. Fastow two years ago. The LJM Cayman partnership raised a relatively modest \$16 million, according to the documents. The more ambitious LJM2 aimed to raise at least \$200 million, the documents show.

17. According to the LJM2 offering document, and Enron's 2001 Proxy Statement, Fastow was the managing member of LJM2's general partner. Management fees paid to the general partner (which was equitably owned by Fastow and at least one other Enron employee) were as much as 2% annually of the total amounts invested. Additionally, the general partner was eligible for profit participation that could produce millions of dollars more if the partnership met its performance goals over its projected 10-year life. In exchange, the general partner was obliged to invest at least 1% of the aggregate capital commitments. The *Wall Street Journal* reported on October 19, 2001: "Mr. Fastow, and possibly a handful of partnership associates, realized more than \$7 million last year in management fees and about \$4 million in capital increases on an



investment of nearly \$3 million in the partnership, which was set up in December 1999 principally to do business with Enron." Thus, his involvement with the partnership was unusually lucrative for Fastow.

18. Despite statements designed to make the partnership deals seem innocuous, the positions Fastow held with the partnerships (and Enron) allowed Fastow to benefit from the illicit use of confidential, non-public information. An egregious example of this occurred in connection with a \$30 million LJM2 investment in a project known as "Raptor III" in September, 2000. This transaction involved writing put options committing LJM2 to buy Enron stock at a set price for six months. Writers of put options benefit from higher prices of the underlying stock, and are hurt by declining prices. As reported in the *Wall Street Journal* on October 19, 2001: "Only four months into this six month deal, LJM2 approached Enron to settle the investment early, causing LJM2 to receive its \$30 million capital invested, plus \$10.5 million in profit." The information quoted came from an internal report produced by defendant Fastow for the partnership investors, but withheld from the public. The article further reported that: "The renegotiation was before a decline in Enron's stock price, which could have forced LJM2 to buy Enron shares at a loss of as much as \$8 each." Thus, Fastow and LJM2 took advantage of inside information to reap illicit insider trading profits, in the millions of dollars in this transaction alone.

19. Other Enron insiders, also privy to adverse non-public information about Enron's true financial condition, also bailed out of their Enron shares at the same time, reaping huge insider trading profits:

Enron Chairman Kenneth Lay: sold 84,714 shares from Jan. 2 to Jan. 31, 2001 for \$68.28 to \$82 each, or more than \$5.78 million; and sold 80,680 shares from Dec. 1 to Dec. 29 for \$67.19 to \$84.06 each, or more than \$5.42 million. The sales total \$11.2 million.

Enron Former Chief Executive Officer Jeffrey Skilling: sold 50,000 shares from Jan. 3 to Jan 31 for \$68.94 to \$80.28 each, or more than \$3.45 million; sold 20,000 shares from Dec. 20 to Dec. 27 for \$79.03 to \$83 each, or more than \$1.58 million, and 20,000 shares from Dec. 6 to Dec. 13 for \$68.91 to \$77.06, or \$1.38 million. The sales total \$6.41 million.

Mark Prevert, Enron Wholesale Services chairman and chief executive: sold 180,000 shares from Dec. 18 to Dec. 20 for \$79 to \$79.98 each, or more than \$14.2 million. The sale brought his holdings to 223,771 shares.

Cliff Baxter, Enron vice chairman and chief strategy officer, who sold 174,215 shares from Jan. 2 to Jan. 31 for \$69.44 to \$81.31 each, or more than \$12.10 million. The sale brought his holdings to 7,877 shares.

Ken Rice, chairman and chief executive of Enron Broadband Services Inc.; sold 32,000 shares from Jan. 3 to Jan. 31 for \$68.19 to \$82 each, or more than \$12.10 million; sold 100,000 shares on Dec. 13 for \$76.69 each, or \$7.67 million. The sales total \$9.185 million and brought Rice's holdings to 113,127 shares.

Steve Kean, Enron executive vice president and chief of staff: sold 77,822 shares on Jan. 31 for \$79.84 to \$80 each, or more than \$6.21 million. The sale brought his holdings to 26,363 shares.

Stanley Horton, chairman and chief executive of Enron Gas Pipeline Group and EOTT Energy Partners-LP: sold 25,000 shares Jan. 29 for \$80.51 each, or \$2.01 million, and 25,000 shares Dec. 27 for \$80.96 each, or \$2.02 million. The sales total[ed] \$4.04 million and brought his holdings to 144,217 shares.

Richard Buy, Enron executive vice president and chief risk officer: sold 47,724 shares from Jan. 2 to Jan. 26 for \$81.90 to \$82 each; or \$3.91 million. The sale brought his holdings to 9,257 shares.

20. In total, the insider selling by defendants Enron insiders totals more than \$73 million.

21. Had these insiders waited just a few more months to sell, the proceeds they would have received would have been substantially less. As revelations about Enron's declining business came out, the stock dropped precipitously. By selling when they did, in tandem with Fastow's illicit



maneuvers, the Enron insiders listed above reaped tens of millions in improperly obtained proceeds.

22. Finally, the fallout from the revelations about the partnership wrongdoing has had negative financial repercussions for Enron. These include a steep decline in its stock price, — its stock now trades for a mere \$.74 cents per share — down from a fifty-two week high of \$84.875 per share, a loss of investor and Wall Street confidence, and increased costs of attracting and retaining employees. The Company's cover up of the Fastow agreement and other related transactions has subjected Enron to strong criticism from investors and analysts alike and ultimately resulted in the filing of numerous securities fraud actions and the failure of Enron to continue to function as a viable entity without the protection of the bankruptcy court.

**Enron Admits That Its Directors, Including Frank Savage, Had Actual Knowledge of the Massive Financial Fraud Conceived By Enron CFO Fastow, And That The Enron Board Expressly Authorized The Illicit Partnership Transactions And Acknowledges That The Fraud Required The Restatement of Five Years Of Financial Statements**

23. In a Form 8-K filed by Enron with the SEC on November 8, 2000 Enron admitted in relevant part:

LJM1 and LJM2 were described to the Enron Board of Directors as potential sources of capital to buy assets from Enron, potential equity partners for Enron, and counterparties to help mitigate risks associated with Enron investments. The Board was also informed that LJM1 and LJM2 intended to transact business with third parties. Prior to approving Mr. Fastow's affiliation with LJM1 and LJM2, the Board determined that Mr. Fastow's participation in the partnerships would not adversely affect the interests of Enron. The Board approved the initial transaction with LJM1 and recognized that Enron may (but was not required to) engage in additional transactions with LJM1. . . . The Board required review and approval of each transaction by the Office of the Chairman, the Chief Accounting Officer and the Chief Risk Officer. The Board also recognized the ability of the Chairman of the Board to require Mr. Fastow to resign from the partnerships at any time, and directed that the Audit and Compliance Committee conduct annual reviews of transactions between Enron and LJM1 and LJM2 completed during the



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prior year. Whether these control's and procedures were properly implemented is a subject of the Special Committee's investigation.

(Emphasis added).

24. The same Form 8-K also shed some initial light on the magnitude of the massive financial fraud that had been perpetrated by senior Enron executives -- a fraud that was conducted with the knowledge of Enron's Board of Directors, including Frank Savage. In this vein, the Form 8-K stated in relevant part that: (i) Enron's prior period financial statements were required to be restated in order to reflect a \$1.2 billion reduction in shareholder's equity reported by Enron in the third quarter of 2001; (ii) "Enron intends to restate its financial statements for the years ended December 31, 1997 through 2000 and the quarters ended March 31 and June 30, 2001"; and that (iii) Enron's Board of Directors had appointed a Special Committee to review transactions between Enron and related parties.

25. On December 2, 2001 Enron finally collapsed under the weigh of its own financial fraud when it sought bankruptcy court protection and filed a petition under Chapter 11 of the Bankruptcy Code. Enron's bankruptcy filing has been heralded as the largest ever in United States history.

**The Advisor Breaches Its § 36(b) Fiduciary Duty  
To The Premier Growth Fund And The Fund Incurred  
Hundreds Of Millions Of Dollars In Damages As A Result Thereof**

26. Alliance Capital Management L.P., through at least one of its Directors, namely Frank Savage, has, for a substantial period of time, had knowledge of the fraudulent activities engaged in by Enron as alleged in detail above. Specifically, Alliance Capital Management L.P. directly acquired such knowledge because of Frank Savage's participation in, approval of, and knowledge of, the massive financial fraud perpetrated by Enron as set forth in detail above. In

addition, Alliance Capital Management L.P., by and through Director Savage, and by other means including Form 4's filed by Enron insiders with the SEC, had knowledge that Enron insiders were engaged in selling hundreds of millions of dollars in Enron common stock while in possession of non-public material adverse information concerning Enron and the fraud detailed above.

27. Alliance Capital Management L.P. breached its fiduciary duty to the Premier Growth Fund by, among other things, causing: (i) the Premier Growth Fund to purchase 4.766 million shares of Enron common stock at prices Alliance Capital Management L.P., knew to be materially artificially inflated in April and/or May of 2001. Enron shares traded at a high price of \$ 63.66 and a low of \$53.50 during the month of April 2001 and a high price of \$ 62.41 and a low of \$52.20 during the month of May 2001. Alliance Capital Management L.P. knew that these prices were materially artificially inflated because Alliance Capital Management L.P. Director Savage had knowledge of the fraud and had, along with Enron's other Board members approved of Fastow and Enron's fraudulent conduct; (ii) the Premier Growth Fund to purchase 4.766 million shares of Enron common stock at prices Alliance Capital Management L.P., knew to be materially artificially inflated in April and/or May of 2001 with knowledge that Enron insiders were engaged in illegal insider trading and were selling millions of shares of Enron common stock while they were in possession of non-public material adverse information concerning the fraud that had been perpetrated by Enron and the undisclosed true state of financial affairs at Enron, thereby effectively providing the Enron insiders who were illegally engaged in insider selling during the months of April and May 2001 with a ready, willing and able purchaser for the nearly 1.3 million Enron shares these Enron insiders sought to dump on unsuspecting victims at materially artificially inflated prices. Such misconduct was tantamount



in Alliance Capital Management L.P., while acting as the Premier Growth Fund's investment Adviser, having permitted these Enron insiders to effectively loot the assets of the Premier Growth Fund — a fund to which Alliance Capital Management L.P. owed a statutory fiduciary duty.

28. Alliance Capital Management L.P. also further breached its fiduciary duties to the Premier Growth Fund when it failed to act to preserve the assets of the Premier Growth Fund, as it was statutorily obligated to, beginning in at least October 2001 when the initial disclosures concerning Enron's wrongdoing first surfaced. As a statutory fiduciary Alliance Capital Management L.P. was required to preserve the assets of the Premier Growth Fund and could have acted to do so by causing the Premier Growth Fund to sell part or all of its 7.199 million share Enron common stock position when the news of Enron's fraud surfaced in October 2001. Rather than acting in furtherance of its fiduciary duty to the Premier Growth Fund, however, Alliance Capital Management L.P. caused the Premier Growth Fund to retain its 7.1 million Enron share position even as the price of Enron shares plummeted from nearly \$30 per share to a mere \$.74 cents per share. Alliance Capital Management L.P. was motivated to serve Enron's interest by causing the Premier Growth Fund to retain its multi-million share position because Alliance Capital Management L.P. and its Director Frank Savage, were well aware of the fact that, if Alliance Capital Management L.P. caused the Premier Growth Fund to quickly liquidate its multi-million Enron share position, Wall St. would view this act as a sign of severe lack of confidence by the Alliance mutual fund family and trouble at Enron, and that such an interpretation could result in massive sales of Enron stock by other large institutional investors. Such selling would have caused the price of Enron shares to decline rapidly and would have triggered covenants in certain of the partnerships that Enron had entered into, thereby requiring



Enron to issue and/or pledge an increasing number of Enron shares in order to fulfill Enron's contractual partnership commitments, thereby resulting in a phenomenon known on Wall St. as a "death spiral." Thus, Alliance Capital Management L.P. and its Director Frank Savage, well aware of these facts, acted to aid Enron by causing the Premier Growth Fund to retain its multi-million Enron share position in violation of the statutory fiduciary duty that Alliance Capital Management L.P. owed to the Premier Growth Fund. As a direct, proximate and foreseeable result of not having acted to preserve the Premier Growth Fund's assets, Alliance Capital Management L.P. thereby caused the Premier Growth Fund to incur hundreds of millions of dollars in damages as the Premier Growth Fund's Enron position plummeted in value.

**Count I**

**Against Alliance Capital Management L.P. For Violation of § 36(b) of the  
Investment Company Act of 1940, 15 U.S.C. § 80a-35(b)**

29. Plaintiff incorporates each of the foregoing paragraphs as if fully set forth herein. This Count is asserted against Alliance Capital Management L.P. as the investment Adviser to the Premier Growth Fund for having breached the fiduciary duty imposed on the Adviser by 15 U.S.C. § 80a-35(b).

30. As the Adviser to the Premier Growth Fund, the Adviser was statutorily required to act with the highest degree of loyalty and fidelity that it owed to the Premier Growth Fund.

31. As set forth above, the Adviser breached its fiduciary duty of loyalty because the Adviser, through one of its Directors, namely Frank Savage, had knowledge of the fraudulent activities engaged in by Enron as alleged in detail above. In addition to having knowledge of the fraud perpetrated by Enron, the Adviser also had knowledge, through Director Savage, that Enron insiders were engaged in selling hundreds of millions of dollars in Enron common stock

activities engaged in by Enron as alleged in detail above. In addition to having knowledge of the fraud perpetrated by Enron, the Adviser also had knowledge, through Director Savage, that Enron insiders were engaged in selling hundreds of millions of dollars in Enron common stock while in possession of non-public material adverse information concerning the massive financial fraud that had been perpetrated by Enron and the true state of financial affairs that existed at Enron.

32. By reason of the conduct alleged herein, Alliance Capital Management L.P. violated Section 36(b) of the Investment Company Act.

33. As a direct, proximate and foreseeable result of such breach on the part of Alliance Capital Management L.P. as the Adviser to the Premier Growth Fund, the Premier Growth Fund incurred hundreds of millions of dollars in damages, for which plaintiff, by this action seeks to recover on behalf of the Premier Growth Fund by seeking to recover the investment adviser fees paid to Alliance Capital Management L.P. by the Premier Growth fund while Alliance Capital Management L.P. was engaged in a breach of the fiduciary duties that it owed to the Premier Growth Fund pursuant to Section 36(b) of the Investment Company Act of 1940 during the twelve month period immediately preceding the filing of this complaint.

#### Prayer for Relief

WHEREFORE, plaintiff, on behalf of the Alliance Premier Growth Fund, respectfully requests that this Court enter judgment in favor of the Alliance Premier Growth Fund and against defendant Alliance Capital Management L.P. as follows

- a. Awarding the appropriate measure of damages;
- b. Awarding prejudgment and post-judgment interest, as well as reasonable attorneys fees, expert witness fees and other costs and expenses; and

DATED: December 7, 2001

LAW OFFICES OF JAMES V. BASHIAN, P.C.



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File

UNITED STATES DISTRICT COURT  
FOR THE MIDDLE DISTRICT OF FLORIDA

SUSANNE ROY, on behalf of  
ALLIANCE PREMIER GROWTH FUND,

Plaintiff,

v.

ALLIANCE CAPITAL MANAGEMENT L.P.

Defendant,

and

ALLIANCE PREMIER GROWTH FUND,

Nominal Defendant.

---

COMPLAINT

Plaintiff, on behalf of the Alliance Premier Growth Fund, by her undersigned counsel, alleges the following upon personal knowledge as to her own acts, and upon information and belief based on the investigation conducted by her counsel as to all other allegations:

NATURE OF THE ACTION

Pursuant to Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35, Plaintiff brings this action on behalf of the Alliance Premier Growth Fund, "Series A," "Series B," "Series C," and the "Advisor Class Series," (collectively hereinafter the "Premier Growth Fund") to recover the investment advisory fees paid by the Premier Growth Fund to its investment adviser, Alliance Capital Management L.P.,

during the prior twelve-month period immediately preceding the institution of this action, in breach of the adviser's fiduciary duty in respect of such compensation.

### JURISDICTION AND VENUE

1. This action arises under Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35 (the "Investment Company Act").

2. The jurisdiction of this Court is based on Section 36(b) of the Investment Company Act and 28 U.S.C. § 1331 (federal question jurisdiction).

3. Venue is proper in this District as the Plaintiff resides at 9994 53<sup>rd</sup> Street in Seminole, Florida, and many of the acts, transactions, and wrongful conduct alleged herein occurred in substantial part in this District.

### THE PARTIES

#### Plaintiff

4. Plaintiff Susanne Roy ("Roy") purchased approximately 160.31 shares of the Premier Growth Fund on October 14, 1999, and 55.772 shares on June 9, 2000, and continues to own such shares.

#### Defendant

5. Alliance Capital Management L.P., (hereinafter the "Adviser") at all times relevant hereto, was and continues to serve as the investment adviser to the Alliance Premier Growth Fund. Acting in its capacity as investment adviser to the Alliance Premier Growth Fund, the Adviser provided investment advice to the Alliance Premier Growth Fund and was compensated therefore. Pursuant to 15 U.S.C. § 80a-35(b), as an



investment adviser to the Alliance Premier Growth Fund, the Adviser owed a statutorily imposed fiduciary duty to the Premier Growth Fund with respect to the receipt of compensation for services. As set forth in detail below, the Adviser breached this fiduciary duty and caused the Premier Growth Fund to incur hundreds of millions of dollars in damages as a result of such breach.

6. According to the Schedule 14A filed with the United States Securities and Exchange Commission ("SEC") by Enron Corp. (hereinafter "Enron") dated March 28, 2000, at all times relevant hereto, Mr. Frank Savage "Savage" served as a Director of the Adviser and thereby owed the Adviser a fiduciary duty of loyalty. In addition, according to the same proxy statement, during all times relevant hereto, Savage also served as a Director of Enron.

#### Nominal Defendant

7. Alliance Premier Growth Fund is a registered investment company under the Investment Company Act of 1940, 15 U.S.C. § 80a-1, et seq. According to the Alliance Premier Growth Fund Semi-Annual Report dated May 31, 2001, "under the terms of an investment advisory agreement, the Fund pays [the Adviser] an advisory fee equal to the annualized rate of 1.00% of the Fund's average daily net assets up to \$5 billion, .95% of the next \$2.5 billion of the Fund's average daily net assets, .90% of the next \$2.5 billion of the Fund's average daily net assets, and .85% of the Fund's average daily net assets over \$10 billion. Such fee is accrued daily and paid monthly." The Alliance Premier Growth Fund paid the Adviser investment adviser fees of

approximately \$140 million during the twelve-month period immediately preceding the filing of this action. By virtue of the Adviser's breach of fiduciary duty as specifically alleged below, the Premier Growth Fund incurred hundreds of millions of dollars in damages.

### **SUBSTANTIVE ALLEGATIONS**

#### **The Enron Fraud**

8. Enron is a corporation organized and existing under the laws of the State of Oregon with principal corporate offices located in Houston, Texas. Enron provides products and services related to natural gas, electricity and communications to wholesale and retail customers. Enron's operations are conducted through its subsidiaries and affiliates, which are principally engaged in the: (i) transportation of natural gas through pipelines to markets throughout the United States; (ii) generation, transmission and distribution of electricity to markets in the northwestern United States; (iii) marketing of natural gas, electricity and other commodities and related risk management and finance services worldwide; (iv) development, construction and operation of power plants, pipelines and other energy related assets worldwide; (v) delivery and management of energy commodities and capabilities to end-use retail customers in the industrial and commercial business sectors; and (vi) development of an intelligent network platform to provide bandwidth management services and the delivery of high bandwidth communication applications. Enron common stock is actively traded on the New York Stock Exchange under the symbol "ENE."



9. Frank Savage is, and has been, an Enron director since 1999. Mr. Savage has also simultaneously served as a Director of Alliance Capital Management L. P., the Adviser to the Premier Growth Fund. In addition, Savage has also served as Chairman of Alliance Capital Management International, a division of Alliance Capital Management L.P.

10. On October 16, 2001, Enron announced that it was taking a \$1.01 billion charge mostly connected with write-downs of soured investments, producing a \$618 million third-quarter loss.

11. On October 17, 2001, the *Wall Street Journal* reported that, while the mere size of the \$1 billion plus dollar charge had raised questions on Wall Street, analysts were more concerned with the fact that \$35 million of the charge stemmed from losses incurred by "a pair of limited partnerships that until recently were run by Enron's chief financial officer." In making the announcement, Enron commented that "the charge connected with the partnerships is \$35 million and involves the 'early termination . . . of certain structured finance arrangements.'"

According to the Wall St. Journal, "two years ago, [Enron's] chief financial officer, Andrew S. Fastow, entered into the unusual arrangement with his employer. With the approval of the board of Enron, Mr. Fastow set up and ran the partnerships that stood to make him millions or more, according to partnership documents." (Emphasis added).

12. As reported, "the two partnerships, LJM Cayman LP and the much larger LJM2 Co-Investment LP, have engaged in billions of dollars of complex hedging transactions with Enron involving company assets and millions of shares of Enron stock."



13. Mr. Fastow's role as chief financial officer made him privy to internal asset analyses at Enron. An offering memorandum for the LJM2 Co-Investment, L.P. ("LJM2") partnership said that this dual role "should result in a steady flow of opportunities . . . to make investments at attractive prices,"

14. Incredibly, the document went so far as to expressly acknowledge the glaring conflict of interest that existed under this agreement and the multi-million dollar incentive for Fastow to engage in self-dealing to the detriment, and at the expense of, Enron and its stockholders to whom he and Enron's Board of Directors owed a fiduciary duty and states that this dual role "should result in a steady flow of opportunities . . . to make investments at attractive prices and that Mr. Fastow would find his interests "aligned" with investors because the "economics of the partnership would have significant impact on the general partner's [Mr. Fastow's] wealth." (Emphasis added).

15. In late July, 2001, Mr. Fastow severed his relations with the partnerships, according to an Enron SEC filing. Enron officials said that move was partly related to questions raised by analysts and large Enron shareholders. And it has recently been reported that the partnerships have been liquidated, or are in the process of being liquidated.

16. Little about the inner workings of the LJM partnerships has been disclosed to date. Private partnership documents indicate that Enron agreed to a partnership arrangement with potentially huge financial rewards for Mr. Fastow two years ago. The LJM Cayman partnership raised a relatively modest \$16 million, according to the documents. The more ambitious LJM2 aimed to raise at least \$200 million, the documents show.

17. According to the LJM2 offering document, and Enron's 2001 Proxy Statement, Fastow was the managing member of LJM2's general partner. Management fees paid to the general partner (which was equitably owned by Fastow and at least one other Enron employee) were as much as 2% annually of the total amounts invested. Additionally, the general partner was eligible for profit participation that could produce millions of dollars more if the partnership met its performance goals over its projected 10-year life. In exchange, the general partner was obliged to invest at least 1% of the aggregate capital commitments. The *Wall Street Journal* reported on October 19, 2001: "Mr. Fastow, and possibly a handful of partnership associates, realized more than \$7 million last year in management fees and about \$4 million in capital increases on an investment of nearly \$3 million in the partnership, which was set up in December 1999 principally to do business with Enron." Thus, his involvement with the partnership was unusually lucrative for Fastow.

18. Despite statements designed to make the partnership deals seem innocuous, the positions Fastow held with the partnerships (and Enron) allowed Fastow to benefit from the illicit use of confidential, non-public information. An egregious example of this occurred in connection with a \$30 million LJM2 investment in a project known as "Raptor II" in September, 2000. This transaction involved writing put options committing LJM2 to buy Enron stock at a set price for six months. Writers of put options benefit from higher prices of the underlying stock, and are hurt by declining prices. As reported in the *Wall Street Journal* on October 19, 2001: "Only four months into this six month deal, LJM2



approached Enron to settle the investment early, 'causing LJM2 to receive its \$30 million capital invested, plus \$10.5 million in profit.'" The information quoted came from an internal report produced by defendant Fastow for the partnership investors, but withheld from the public. The article further reported that: "The renegotiation was before a decline in Enron's stock price, which could have forced LJM2 to buy Enron shares at a loss of as much as \$8 each." Thus, Fastow and LJM2 took advantage of inside information to reap illicit insider trading profits, in the millions of dollars in this transaction alone.

19. Other Enron insiders, also privy to adverse non-public information about Enron's true financial condition, also bailed out of their Enron shares *at the same time*, reaping huge insider trading profits:

Enron Chairman Kenneth Lay: sold 84,714 shares from Jan. 2 to Jan. 31, 2001 for \$68.28 to \$82 each, or more than \$5.78 million; and sold 80,680 shares from Dec. 1 to Dec. 29 for \$67.19 to \$84.06 each, or more than \$5.42 million. The sales total \$11.2 million.

Enron Former Chief Executive Officer Jeffrey Skilling: sold 50,000 shares from Jan. 3 to Jan. 31 for \$68.94 to \$80.28 each, or more than \$3.45 million; sold 20,000 shares from Dec. 20 to Dec. 27 for \$79.03 to \$83 each, or more than \$1.58 million, and 20,000 shares from Dec. 6 to Dec. 13 for \$68.91 to \$77.06, or \$1.38 million. The sales total \$6.41 million.

Mark Frevert, Enron Wholesale Services chairman and chief executive: sold 180,000 shares from Dec. 18 to Dec. 20 for \$79 to \$79.98 each, or more than \$14.2 million. The sale brought his holdings to 223,771 shares.

Cliff Baxter, Enron vice chairman and chief strategy officer, who sold 174,215 shares from Jan. 2 to Jan. 31 for \$69.44 to \$81.31 each, or more than \$12.10 million. The sale brought his holdings to 7,877 shares.

Ken Rice, chairman and chief executive of Enron Broadband Services Inc.; sold 32,000 shares from Jan. 3 to Jan. 31 for \$68.19 to \$82 each, or more than \$12.10 million; sold 100,000 shares on Dec. 13 for \$76.69 each, or



\$7.67 million. The sales total \$9.185 million and brought Rice's holdings to 113,127 shares.

Steve Kean, Enron executive vice president and chief of staff: sold 77,822 shares on Jan. 31 for \$79.84 to \$80 each, or more than \$6.21 million. The sale brought his holdings to 26,363 shares.

Stanley Horton, chairman and chief executive of Enron Gas Pipeline Group and EOTT Energy Partners-LP: sold 25,000 shares Jan. 29 for \$80.51 each, or \$2.01 million, and 25,000 shares Dec. 27 for \$80.96 each, or \$2.02 million. The sales total[ed] \$4.04 million and brought his holdings to 144,217 shares.

Richard Buy, Enron executive vice president and chief risk officer: sold 47,724 shares from Jan. 2 to Jan. 26 for \$81.90 to \$82 each, or \$3.91 million. The sale brought his holdings to 9,257 shares.

20. In total, the insider selling by Enron insiders totals more than \$73 million.

21. Had these insiders waited just a few more months to sell, the proceeds they would have received would have been substantially less. As revelations about Enron's declining business came out, the stock dropped precipitously. By selling when they did, in tandem with Fastow's illicit maneuvers, the Enron insiders listed above reaped tens of millions in improperly obtained proceeds.

22. Finally, the fallout from the revelations about the partnership wrongdoing has had negative financial repercussions for Enron. These include a steep decline in its stock price, -- its stock now trades for a mere \$.74 cents per share -- down from a fifty-two week high of \$84.875 per share, a loss of investor and Wall Street confidence, and increased costs of attracting and retaining employees. The Company's cover-up of the Fastow agreement and other related transactions has subjected Enron to strong criticism from investors and analysts alike and ultimately resulted in the filing of numerous



securities fraud actions and the failure of Enron to continue to function as a viable entity without the protection of the bankruptcy court.

**Enron Admits that Its Directors, Including Frank Savage, had Actual Knowledge of the Massive Financial Fraud Conceived by Enron CFO Fastow, and that the Enron Board Expressly Authorized the Illicit Partnership Transactions and Acknowledges that the Fraud Required the Restatement of Five Years of Financial Statements**

23. In a Form 8-K filed by Enron with the SEC on November 8, 2000 Enron admitted in relevant part:

LJM1 and LJM2 were described to the Enron Board of Directors as potential sources of capital to buy assets from Enron, potential equity partners for Enron, and counterparties to help mitigate risks associated with Enron investments. The Board was also informed that LJM1 and LJM2 intended to transact business with third parties. Prior to approving Mr. Fastow's affiliation with LJM1 and LJM2, the Board determined that Mr. Fastow's participation in the partnerships would not adversely affect the interests of Enron. The Board approved the initial transaction with LJM1 and recognized that Enron may (but was not required to) engage in additional transactions with LJM1. . . . The Board required review and approval of each transaction by the Office of the Chairman, the Chief Accounting Officer and the Chief Risk Officer. The Board also recognized the ability of the Chairman of the Board to require Mr. Fastow to resign from the partnerships at any time, and directed that the Audit and Compliance Committee conduct annual reviews of transactions between Enron and LJM1 and LJM2 completed during the prior year. Whether these control's and procedures were properly implemented is a subject of the Special Committee's investigation.

(Emphasis added).

24. The same Form 8-K also shed some initial light on the magnitude of the massive financial fraud that had been perpetrated by senior Enron executives -- a fraud

that was conducted with the knowledge of Enron's Board of Directors, including Frank Savage. In this vein, the Form 8-K stated in relevant part that: (i) Enron's prior period financial statements were required to be restated in order to reflect a \$1.2 billion reduction in shareholder's equity reported by Enron in the third quarter of 2001; (ii) "Enron intends to restate its financial statements for the years ended December 31, 1997, through 2000 and the quarters ended March 31 and June 30, 2001"; and that (iii) Enron's Board of Directors had appointed a Special Committee to review transactions between Enron and related parties.

25. On December 2, 2001, Enron finally collapsed under the weigh of its own financial fraud when it sought bankruptcy court protection and filed a petition under Chapter 11 of the Bankruptcy Code. Enron's bankruptcy filing has been heralded as the largest ever in United States history.

**The Advisor Breaches its § 36(b) Fiduciary Duty  
to the Premier Growth Fund and the Fund  
Incurred Hundreds of Millions of Dollars in  
Damages as a Result Thereof**

26. Alliance Capital Management L.P., through at least one of its Directors, namely Frank Savage, has, for a substantial period of time, had knowledge of the fraudulent activities engaged in by Enron as alleged in detail above. Specifically, Alliance Capital Management L.P. directly acquired such knowledge because of Frank Savage's participation in, approval of, and knowledge of, the massive financial fraud perpetrated by Enron as set forth in detail above. In addition, Alliance Capital



Management L.P., by and through Director Savage, and by other means including Form 4's filed by Enron insiders with the SEC, had knowledge that Enron insiders were engaged in selling hundreds of millions of dollars in Enron common stock while in possession of non-public material adverse information concerning Enron and the fraud detailed above.

27. Alliance Capital Management L.P. breached its fiduciary duty to the Premier Growth Fund by, among other things, causing: (i) the Premier Growth Fund to purchase 4.766 million shares of Enron common stock at prices Alliance Capital Management L.P. knew to be materially artificially inflated in April and/or May of 2001. Enron shares traded at a high price of \$ 63.66 and a low of \$53.50 during the month of April 2001 and a high price of \$ 62.41 and a low of \$52.20 during the month of May 2001. Alliance Capital Management L.P. knew that these prices were materially artificially inflated because Alliance Capital Management L.P. Director Savage had knowledge of the fraud and had, along with Enron's other Board members approved of Fastow and Enron's fraudulent conduct; (ii) the Premier Growth Fund to purchase 4.766 million shares of Enron common stock at prices Alliance Capital Management L.P. knew to be materially artificially inflated in April and/or May of 2001 with knowledge that Enron insiders were engaged in illegal insider trading and were selling millions of shares of Enron common stock while they were in possession of non-public material adverse information concerning the fraud that had been perpetrated by Enron and the undisclosed true state of financial affairs at Enron, thereby effectively providing the Enron insiders

who were illegally engaged in insider selling during the months of April and May 2001 with a ready, willing and able purchaser for the nearly 1.3 million Enron shares these Enron insiders sought to dump on unsuspecting victims at materially artificially inflated prices. Such misconduct was tantamount to Alliance Capital Management L.P., while acting as the Premier Growth Fund's investment Adviser, having permitted these Enron insiders to effectively loot the assets of the Premier Growth Fund – a fund to which Alliance Capital Management L.P. owed a statutory fiduciary duty.

28. Alliance Capital Management L.P. also further breached its fiduciary duties to the Premier Growth Fund when it failed to act to preserve the assets of the Premier Growth Fund, as it was statutorily obligated to, beginning in at least October 2001 when the initial disclosures concerning Enron's wrongdoing first surfaced. As a statutory fiduciary Alliance Capital Management L.P. was required to preserve the assets of the Premier Growth Fund and could have acted to do so by causing the Premier Growth Fund to sell part or all of its 7.199 million share Enron common stock position when the news of Enron's fraud surfaced in October 2001. Rather than acting in furtherance of its fiduciary duty to the Premier Growth Fund, however, Alliance Capital Management L.P. caused the Premier Growth Fund to retain its 7.1 million Enron share position even as the price of Enron shares plummeted from nearly \$30 per share to a mere \$.28 cents per share. Alliance Capital Management L.P. was motivated to serve Enron's interest by causing the Premier Growth Fund to retain its multi-million share position because Alliance Capital Management L.P. and its Director Frank Savage, were well



aware of the fact that, if Alliance Capital Management L.P. caused the Premier Growth Fund to quickly liquidate its multi-million Enron share position, Wall Street would view this act as a sign of severe lack of confidence by the Alliance mutual fund family and trouble at Enron, and that such an interpretation could result in massive sales of Enron stock by other large institutional investors. Such selling would have caused the price of Enron shares to decline rapidly and would have triggered covenants in certain of the partnerships that Enron had entered into, thereby requiring Enron to issue and/or pledge an increasing number of Enron shares in order to fulfill Enron's contractual partnership commitments, thereby resulting in a phenomenon known on Wall Street as a "death spiral." Thus, Alliance Capital Management L.P. and its Director Frank Savage, well aware of these facts, acted to aid Enron by causing the Premier Growth Fund to retain its multi-million Enron share position in violation of the statutory fiduciary duty that Alliance Capital Management L.P. owed to the Premier Growth Fund. As a direct, proximate and foreseeable result of not having acted to preserve the Premier Growth Fund's assets, Alliance Capital Management L.P. thereby caused the Premier Growth Fund to incur hundreds of millions of dollars in damages as the Premier Growth Fund's Enron position plummeted in value.

#### Count I

#### **Against Alliance Capital Management L.P. for Violation of § 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35**

29. Plaintiff incorporates each of the foregoing paragraphs as if fully set forth herein. This Count is asserted against Alliance Capital Management L.P. as the



investment Adviser to the Premier Growth Fund for having breached the fiduciary duty imposed on the Adviser by 15 U.S.C. § 80a-35.

30. As the Adviser to the Premier Growth Fund, the Adviser was statutorily required to act with the highest degree of loyalty and fidelity that it owed to the Premier Growth Fund.

31. As set forth above, the Adviser breached its fiduciary duty of loyalty because the Adviser, through one of its Directors, namely Frank Savage, had knowledge of the fraudulent activities engaged in by Enron as alleged in detail above. In addition to having knowledge of the fraud perpetrated by Enron, the Adviser also had knowledge, through Director Savage, that Enron insiders were engaged in selling hundreds of millions of dollars in Enron common stock while in possession of non-public material adverse information concerning the massive financial fraud that had been perpetrated by Enron and the true state of financial affairs that existed at Enron.

32. By reason of the conduct alleged herein, Alliance Capital Management L.P. violated Section 36(b) of the Investment Company Act.

33. As a direct, proximate and foreseeable result of such breach on the part of Alliance Capital Management L.P. as the Adviser to the Premier Growth Fund, the Premier Growth Fund incurred hundreds of millions of dollars in damages, for which plaintiff, by this action seeks to recover on behalf of the Premier Growth Fund by seeking to recover the investment adviser fees paid to Alliance Capital Management L.P. by the Premier Growth fund while Alliance Capital Management L.P. was engaged in a breach

of the fiduciary duties that it owed to the Premier Growth Fund pursuant to Section 36(b) of the Investment Company Act of 1940 during the twelve-month period immediately preceding the filing of this complaint.

**Prayer for Relief**

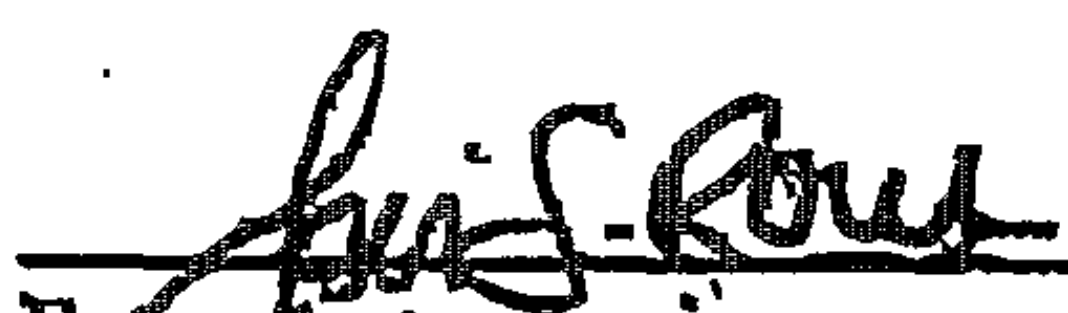
WHEREFORE, Plaintiff, on behalf of the Alliance Premier Growth Fund, respectfully requests that this Court enter judgment in favor of the Alliance Premier Growth Fund and against defendant Alliance Capital Management L.P. as follows

- a. Awarding the appropriate measure of damages;
- b. Awarding prejudgment and post-judgment interest, as well as reasonable attorneys fees, expert witness fees and other costs and expenses; and
- c. Awarding such other relief as this Court may deem just and proper.

**Jury Demand**

Plaintiff demands a trial by jury.

DATED: December 20th, 2001.

  
\_\_\_\_\_  
Peter Antonacci  
Florida Bar No. 280690  
Lori S. Rowe  
Florida Bar No. 0120294  
GRAY, HARRIS & ROBINSON, P.A.  
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DECLARATION OF SERVICE BY MAIL

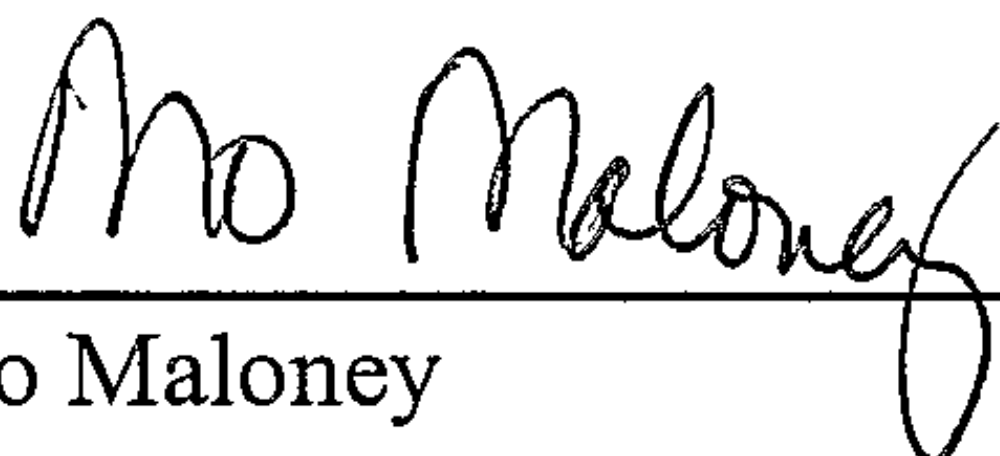
I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Diego, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 401 B Street, Suite 1700, San Diego, California 92101.

2. That on January 22, 2002, declarant served the DECLARATION OF JAMES I. JACONETTE IN FURTHER SUPPORT OF THE LEAD PLAINTIFF MOTION OF THE REGENTS OF THE UNIVERSITY OF CALIFORNIA AND IN OPPOSITION TO THE COMPETING LEADPLAINTIFF MOTIONS by depositing a true copy thereof in a United States mailbox at San Diego, California in a sealed envelope with postage thereon fully prepaid and addressed to the parties listed on the attached Service List.

3. That there is a regular communication by mail between the place of mailing and the places so addressed.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 22nd day of January, 2002, at San Diego, California.

  
\_\_\_\_\_  
Mo Maloney



COUNSEL FOR PLAINTIFF(S)

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